Supreme Court, U.S.
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No.

In the
Supreme Court of the United States

OCTOBER TERM 2000

MINDGAMES, INC.

Petitioner,

v.

WESTERN PUBLISHING COMPANY, INC.

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Has the Seventh Circuit imposed an unnecessary and confusing burden on trial courts and litigants by forcing nonmoving parties in summary judgment proceedings to anticipate and make an evidentiary record on all potentially dispositive issues, no matter how limited the summary judgment motion made?

2. Did the Seventh Circuit depart from the usual course of judicial proceedings and violate rulings of this Court when it affirmed *sua sponte* partial summary judgment dismissing MindGames' claim for lost profits on grounds not raised by Western in or considered by the district court, unsupported by the record, without notice to MindGames and as to which no opportunity was afforded to present evidence?

3. Did the Seventh Circuit violate rulings of this court by preferring anti-Mindgames' inferences over available reasonable inferences favoring MindGames on controlling issues?

PARTIES TO THE PROCEEDINGS

The caption contains the names of all parties.

MindGames, Inc., is an Arkansas corporation. It has no parent and no publicly held company owns ten percent or more of its stock.

Western Publishing Company, Inc., is now known as Golden Books Publishing Company, Inc. Its parent corporation is Golden Books Family Entertainment, Inc., a Delaware corporation. Petitioner is unaware of any other publicly held company that owns ten percent or more of Golden Books Publishing Company, Inc.'s stock.

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PETITION FOR WRIT OF CERTIORARI

MindGames, Inc., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit dated June 22, 2000. By affirming a summary judgment dismissal on grounds not raised in or considered by the district court, concerning which there is no supporting record and of which the nonmoving party had no fair notice or opportunity to make its record in opposition, and by selecting among competing inferences those that favored the movant, the court departed from the accepted and usual course of judicial proceedings so as to call for an exercise of this Court's supervisory power and decided important questions in a way that conflicts with relevant decisions of this Court, all within the meaning of Sup. Ct. R. 10(a) and (c).

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit that gives rise to this petition was filed on June 22, 2000. It is reprinted in the appendix hereto at App. 1-19. By order filed August 22, 2000, the Seventh Circuit denied a petition for rehearing. App. 40. The appeal to the Court of Appeals was from decisions in the United States District Court for the Eastern District of Wisconsin, dated October 11, 1996 and February 25, 1998 and the final judgment based thereon entered March 20, 1998. The decisions and judgment granting summary judgment are reprinted in the appendix hereto at App. 20 and App. 42.

JURISDICTION

The jurisdiction of this Court is based upon 28 U.S.C. § 1254(1). The judgment of the court of appeals was entered on June 22, 2000. The petition of MindGames, Inc., for rehearing and rehearing *en banc* was denied on August 22, 2000. This petition is filed within ninety days of the petition for rehearing and rehearing *en banc*, as extended by Supreme Court Rule 29.2.

CONSTITUTIONAL PROVISIONS AND FEDERAL RULES INVOLVED IN THIS CASE

UNITED STATES CONSTITUTION: AMENDMENT V

No person shall . . . be deprived of life, liberty, or property, without due process of law; . . .

UNITED STATES CONSTITUTION: AMENDMENT VII

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

Rule 56 (c) and (e), Federal Rules of Civil Procedure

(c) Motion and Proceedings Thereon. The motion [for summary judgment] shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

(e) Form of Affidavits; Further Testimony; Defense Required. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to

interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party.

STATEMENT OF THE CASE

A. Statement of Facts

This is a diversity action for damages by MindGames, Inc. ("MindGames"), as licensor, against Western Publishing Company, Inc. ("Western"), as licensee, for breach of a license agreement ("License") relating to a patented adult board game known as *Cleavor Endeavor*.

Larry Blackwell invented *Clever Endeavor* on which a patent was issued in 1991. He assigned the rights to MindGames, which he established to manufacture and market the game.

MindGames began selling *Clever Endeavor* in September 1989. Approximately 30,000 copies were sold through more than 400 retailers coast-to-coast in its first 75 days on the market. The game received high praise in the press and won many awards. Many retailers sold out of the game during the 1989 Christmas season, at a pace even faster than "blockbuster" games of the era.

In March 1990 MindGames licensed *Clever Endeavor* to Western, the second largest game company in America, and Games Gang, Ltd., a major marketer of games including *Trivial Pursuit* and *Pictionary*, both hugely successful. The License called for the payment of royalties to MindGames of about 15% of game sales.

Western and Games Gang representatives told Blackwell at the 1990 Toy Fair in New York (the principle game/toy trade show in the United States) that they regarded *Clever Endeavor* as the "next *Pictionary*" and "next *Trivial Pursuit*." *Clever Endeavor*'s excellent early track record enabled MindGames to negotiate a significantly more favorable royalty arrangement (15%) than the "standard" 3%-7%.

MindGames alleges Western and Games Gang breached the License in many respects over the three years of the License which proved fatal for *Clever Endeavor*. The breaches were not put in issue by the summary judgment motions.

MindGames claims damage for loss of future royalties based upon the failure of Western and Games Gang to fulfill their obligations under the License. These breaches destroyed the value of the game in the marketplace and prevented it from reaching even a fraction of the potential widely recognized for it when the License was entered into, even though the game generated royalties of approximately $600,000 on sales of over $4 million. MindGames claims that, properly handled, the game would likely have generated far greater royalties than it did.

B. Course of Proceedings Below.

On May 25, 1994 MindGames filed this breach of contract action in the U.S. District Court for the Eastern District of Arkansas seeking, among other relief, royalties and lost profits arising from the breach of the *Clever Endeavor* License.

On the same day, Western filed a declaratory judgment action in the U.S. District Court for the Eastern District of Wisconsin seeking a ruling that it did not owe MindGames any monies arising out of the License.

The Arkansas court granted Western's motion to transfer MindGames' action to Wisconsin pursuant to 28 U.S.C § 1404(a), where the two cases were consolidated.

The License called for the application of Arkansas law. On October 11, 1996 the district court granted Western's motion for partial summary judgment, holding that MindGames was a "new business" (App. 33), that new businesses may not make claim for lost profits as a matter of Arkansas law (App. 28) and dismissed MindGames' claim for lost profit damages.[1] App. 38.

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[1] On February 25, 1998, the district court granted Western's second motion for partial summary judgment holding that, as a matter of Arkansas law, MindGames is not entitled to recover approximately $1.2 million in renewal fees arising out of the License or any extension of it. This ruling, which the Seventh Circuit affirmed, is not an issue here.

MindGames asserted certain other damage claims. The parties entered into a tolling agreement relating to these non-dismissed claims which were then dismissed without prejudice on March 20, 1998.

MindGames filed its notice of appeal on April 3, 1998. On June 22, 2000 the Seventh Circuit Court of Apeals unanimously rejected the "new business" rule relied on by the district court in dismissing MindGames' claim for lost profits (Opinion at App. 7-12; dissent at App. 15) but, *sua sponte* and by a divided court, affirmed the dismissal on the ground MindGames had offered no evidence of lost sales in the district court. App. 14.

MindGames filed a timely petition for rehearing and rehearing *en banc* which was denied on August 22, 2000, with Judge Fairchild voting to grant rehearing. App. 40-41.

C. Basis for Federal Jurisdiction.

The jurisdiction of the district court was based upon 28 U.S.C. § 1332, in that the matter in controversy exceeds the sum of $75,000, exclusive of interest and costs, and is between citizens of different states. MindGames is a citizen of the State of Arkansas and Western is a citizen of the State of Wisconsin.

The jurisdiction of the court of appeals was based upon 28 U.S.C. § 1291. The summary judgment orders appealed from were entered on October 11, 1996 and February 25, 1998 and became final on March 20, 1998 when a judgment was entered dismissing all claims and causes of action of the plaintiff not previously dismissed on summary judgment. By stipulation all claims of Western Publishing Company, Inc., in a companion case were dismissed without prejudice on May 1, 1998, *nunc pro tunc* as of March 20, 1998. The filing date of the notice of appeal was April 3, 1998.

REASONS FOR GRANTING THE WRIT

I. Introduction: What the Court of Appeals Did and Why It Raises an Important Issue for this Court.

The ruling of the majority in this case puts summary judgment nonmovants in an almost impossible position and forces them to prove every element of their cases at the summary judgment stage lest the court of appeals dismiss for lack of evidence on a ground not raised by the movant, not ruled on by the district court and without the responding party having been notified of the need to produce evidence. Heretofore, a nonmoving party has been required only to respond to specific issues identified by the moving party or the court. If the ruling here stands, no party facing a motion for summary judgment in the Seventh Circuit can afford to present only proof and legal argument addressing the point of the motion and such other issues as the district court may identify. Rather, the respondent must now anticipate and deal with *every* issue that might some day be of concern to the appellate court.

The court of appeals unanimously held the "new business" rule, if still valid at all in Arkansas, would not apply to MindGames' claims for lost royalties, rejecting Western's invitation to follow *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924). App. 7-12; Dissent, App. 15.

Having rejected Western's *only* attack on MindGames' claim for lost royalties, the majority nevertheless affirmed dismissal of the claim on a ground not within either party's statement of issues there and not raised or considered in the

district court: namely, that MindGames failed to prove how many copies of *Clever Endeavor* Western would probably have sold (on which MindGames, as licensor, would earn royalties), absent breach.

> [W]e do not see how the number of copies that would have been sold but for the alleged breach could be determined given the evidence presented in the summary judgment proceedings (a potentially important qualification, of course); and so MindGames' proof of damages is indeed excessively speculative. Those proceedings were completed with no evidence having been presented from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter some broad but bounded range of alternative estimates, of copies of "Clever Endeavor" would have been sold had Western honored the contract.

App. 13-14 (emphasis in original; citations omitted). However, Western had never raised in the district court the issue whether MindGames had evidence from which a jury could reasonably estimate the quantity of games that would have been sold had Western performed.

Consequently, MindGames was never called on to file evidence from which a jury could reasonably determine sales *Clever Endeavor* would likely have achieved had Western performed. It had no notice of the need to present evidence of the *amount* of its lost-royalty damages because Western claimed only that MindGames, as a "new business," was not

entitled to prove any lost profit damages under Arkansas law and the district court did not raise or consider the issue.

Western's sole attack on MindGames' claim for lost royalties was the "new business" rule. The district court saw that as the only issue before it: "Western claims that the 'New Business Rule,' which prevents new and unestablished business ventures from collecting lost profits as damages in breach of contract or tort cases, guides this case as a matter of law, and mandates partial summary judgment in Western's favor." *Western Publishing Co., Inc. v. MindGames, Inc.*, 944 F. Supp. 754, 755 (E.D. Wis. 1996), App. 22.

Western's summary judgment brief in the district court contained a single substantive argument: "The 'New Business Rule' Prevents MindGames From Recovering Any Lost Profits." App. 52. Its proposed findings of fact, required by local rule, did not address whether lost future sales were reasonably provable. Western's reply brief in the district court also dealt only with the "new business" rule, App. 71-88.

The district court brushed aside as "irrelevant" *all* matters not directly relating to the single, legal issue raised by Western -- whether the "new business" rule barred *per se any* attempt to establish lost profits. 944 F. Supp. at 755, n.1, App. 22.

The record made by MindGames did include evidence of specific contract breaches by Western from which damages could readily be inferred and described the variety of damage claims arising from the breaches. Blackwell Summ.Judg.Aff. ¶¶ 26-27 (App. 90-93) and 31-35 (App. 93-96). But a record

on the volume of lost sales was never developed because the issue of whether there was evidence available to MindGames sufficient to prove lost sales was not raised.

The court of appeals majority disregarded the limited scope of the issue Western presented in the district court and that the single ground asserted by Western and considered by the district court – that Arkansas's "new business" rule precluded proof of lost profits as a matter of law – did not require MindGames to develop a record on the issues of breach and the volume of lost sales.

Instead, the majority summarily dismissed the claim for supposed lack of evidence even though MindGames had never been notified it was called upon to present the evidence and was given no opportunity to present it. As argued infra, such summary judgment by ambush is prohibited by this Court's decision in *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986).

The court of appeals majority also grounded its ruling on anti-MindGames' inferences that had no basis in the record and in the face of available reasonable inferences that favored MindGames.

II. The Court of Appeals Majority Departed from the Accepted and Usual Course of Judicial Proceedings and Its Opinion Conflicts with the Fifth and Seventh Amendments and Decisions of this Court in Granting Summary Judgment Sua Sponte without the Non-moving Party Having Fair Notice and an Opportunity to Present Evidence.

The court of appeals penalized MindGames, the nonmovant, for failing to introduce evidence on a damage issue *not* clearly raised by the movant and thereby rewarded the movant for failing to raise an unambiguous defense. Fed. R. Civ. P. 56 was never intended to be such a trap for the unwary.

MindGames and the district court believed Western based its summary judgment motion solely on the "new business" rule. Western did not challenge MindGames to come forward with evidence of lost future sales. No evidence was ever offered by Western to support the proposition that lost profits are unprovable with respect to an entertainment product. The record in this regard contains nothing more than the conclusory statements of Western's counsel, offered as a reason to uphold and apply the "new business" rule.

Nor did the district court request that MindGames make a showing of lost sales and royalties. Had it done so, MindGames could have filed evidence such as market studies, statistical analyses, comparisons of sales results in geographical areas where appropriate promotions and advertising outlets were not used versus those where they were used, projections of sales patterns established prior to the breach, sales forecasts generated by Western, sales

performance by comparable products and comparisons of market results in areas where proper advertising expenditures were made with those where they should have been but were not made. Damages well removed from the realm of speculation can be established by showing canceled orders, orders lost due to late ad campaigns, comparing actual sales results at times and in areas where appropriate advertising was utilized as compared with times and areas where it was not, sales experience with games that were properly packaged and complete versus experience with games that were defectively packaged and had missing pieces. Before-and-after comparisons can be made with respect to the breaches that involve preferring other products, lowering commissions, absence of public relations activity, unauthorized price increases and lapses in advertising.

As required by Fed.R.App.P. 28(b)(2), MindGames set forth the relevant issues presented for review in its main court of appeals brief as follows:

> Did the district court err in holding that, under Arkansas law, the New Business Rule barred MindGames' claim for lost profits where the profits consisted of royalties generated by its experienced licensees and were determined by sales, not profits?

Western's counter-statement contained only one issue relevant to the proof of lost profits:

> Did the District Court err in holding that under Arkansas law, the New Business Rule precluded a licensor from recovering future

> profits it allegedly lost as a result of the licensee's alleged breaches of a license agreement to manufacture and distribute a new adult board game?

Thus, the basis for the majority's affirmance was not given by either party as an issue presented to that court. The issue could not have been presented to the court of appeals because it had not been raised in the district court.

The majority referred to the absence of evidence "from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter, some broad but bounded range of alternative estimates, of copies of 'Clever Endeavor'" would have been sold. App. 14 (emphasis in original). The majority then referred to an argument Western presented to the court of appeals – not the district court – and concluded the "argument was brief but not so brief as to fail to put MindGames on notice of a possible alternative ground for upholding the district court's judgment." App. 15. The majority then faulted MindGames because, in its reply brief, it "pointed to no evidence from which lost royalties could be calculated to even a rough approximation." *Id.*

MindGames, however, had never been called upon to develop and file such evidence below *because the issue of uncertain lost sales had not been raised as a ground for dismissal apart from the "new business" rule*. The dissent recognized this.

> It is true that in responding to Western's motion for partial summary judgment MindGames did not provide evidentiary

> material tending to show the breaches by Western nor that such breaches caused a loss of sales. This should not be deemed a waiver or forfeiture of an opportunity to do so *because of Western's complete reliance in its motion on the new business rule and Marvell, which, if applied, would prevent proof of breach and causation of loss*.

Dissent, App. 17 (emphasis supplied).

Western's appeal brief made an oblique, factually unsupported reference to supposed difficulty of proving lost profits on entertainment products *as a reason for not retreating from the "new business" rule*. MindGames *did* respond in its reply brief to the point of Western's references (an aspect of its "new business" rule argument), and the bulk of MindGames' reply brief was, of course, addressed to the "new business" rule argument generally.

It is manifestly unfair to hold, as the majority did, that the *en passant* references to speculation in Western's appeal brief (a) in fact constituted an argument on an issue Western had not even included in its statement of the issues presented, (b) should have been read by MindGames as raising a separate issue Western was precluded from raising because not presented below, and (c) required MindGames to cite proof it had never been called upon to file below.[2]

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[2] "New business" rule aside, the majority disregarded Arkansas's liberal damage rule permitting lost profit damages in entertainment cases

(continued...)

MindGames' Seventh Amendment right to a jury trial must not be rendered so fragile as to be taken away on such attenuated grounds.

This Court has countenanced reliance on arguments not raised in the district court as a basis for affirmance, but only when decided on the basis of the record developed after fair notice in that court. *Blum v. Bacon*, 457 U.S. 132, 137, n.5 (1982); *Schweiker v. Hogan*, 457 U.S. 569, 585, n.24 (1982). It has never countenanced reliance on arguments of which the non-movant did not have fair notice, compare *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), and that are not supported by any record in the district court.

The court of appeals decision here violates a protection specifically preserved in *Celotex* against summary judgment by ambush. While the *Celotex* court ruled an evidentiary record is not always required of the movant in order to call upon the nonmovant to present a record demonstrating a material issue of fact, the court held notice must at least be given of all issues on which the *nonmovant* is being required to make an evidentiary record. The court stated:

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[2](...continued)
even where the claimant is inexperienced. *Finley v. North River Records, Inc.*, 148 F.3d 913, 918-19 (8th Cir. 1998) (allowing a fledgling music concert promoter to recover lost future profits under Arkansas law despite the absence of prior successes). The uncertainty preventing recovery of lost profits relates to the *fact* of damages, not the *amount*. *Jim Halsey Co. v. Bonar*, 683 S.W.2d 898, 903 (Ark. 1985) (concert promoter could claim lost profits on future concerts despite no evidence of successful earlier promotions). For purposes of the summary judgment motion the "fact" of damage was not questioned and must be presumed.

> Of course, a party seeking summary judgment always bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of the "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any," which it believes demonstrate the absence of a genuine issue of material fact.

477 U.S. at 323. The court then emphasized:

> As we have explained, the burden on the moving party may be discharged by "showing" – that is, pointing out to the district court – that there is an absence of evidence to support the nonmoving party's case.

477 U.S. at 325.

Citing Judge Bork's dissent in the court below, the *Celotex* court acknowledged the power of the district court to grant summary judgment *sua sponte*, but only "*so long as the losing party was on notice that [it] had to come forward with all of [its] evidence*." 477 U.S. at 326 (emphasis supplied). The dissenting opinion this court approved in *Celotex* goes on to state:

> This rule clearly means that summary judgment does not require affirmative evidentiary proof of the absence of a factual dispute. *Rather the trial judge need only notice this absence and demand that it be corrected.* If it is not

> corrected *after notice*, it becomes the trial judge's duty to grant summary judgment to conserve scarce judicial resources and avoid a useless trial.

Catrett v. Johns-Manville Sales Corp., 756 F.2d 181, 189 (D.C. Cir. 1985) (emphasis supplied).

Even where the movant's grounds for a summary judgment motion are limited, the ruling of the court of appeals here effectively requires the nonmovant to anticipate and make a record addressing all potential issues in the case. Where cases could otherwise be determined at an early stage on the basis of a single issue of law, summary judgment motions could not be fairly heard until *all* discovery is complete. This could not have been the intended effect of Fed. R. Civ. P. 56, which was designed to facilitate the efficient and timely disposition of cases under appropriate circumstances.

Where granted on grounds of which the nonmovant has received no effective notice, the summary judgment has been granted without a fair hearing. If the law is to be that, in responding to even a limited motion for summary judgment, the nonmovant must address all possible grounds, litigants must first be told that is the rule. *Celotex* assured them they were safe in responding only to the issues raised. That assurance is violated by the court of appeals decision here.

Fair notice and an opportunity to be heard are essential to due process. A civil cause of action is a property interest entitled to constitutional due process protection. *Tulsa Professional Collection Services, Inc. v. Pope*, 485 U.S. 478, 485 (1988); *Logan v. Zimmerman Brush Co.*, 455 U.S. 422,

428 (1982), a "fair trial in a fair tribunal is a basic requirement of due process," *In re Murchison*, 349 U.S.133, 136 (1955), and this court acknowledges "our 'deep-rooted historic tradition that everyone should have his own day in court.'" *Martin v. Wilks*, 490 U.S. 755, 762 (1989).

MindGames was deprived of due process because it did not have fair notice that it was required to prove its lost profit damages case in the district court at the summary judgment stage.

Western may argue it raised in the district court the alternative ground that MindGames' claim was too speculative irrespective of the "new business" rule.

It did not. What it did argue was that the "new business" rule should be strictly applied because this case involves an entertainment product. App. 63.

Western may point to its district court argument that "even if the [district court] were to reject a strict application of the New Business Rule, [it] should still grant Western's motion for summary judgment because MindGames has no history of past profits." App. 64. Western was here only arguing for a broad application of the "new business" rule because MindGames had no "history of past profits." Neither this assertion nor anything else in Western's summary judgment motion put MindGames on notice of a need to produce evidence or make its record on the effects of Western's contract breaches on future sales of *Clever*

Endeavor.[3] MindGames was entitled to assume defeating application of the "new business" rule defeated summary judgment.

None of MindGames' responsive arguments in the district court departed from the context of Western's summary judgment motion, namely the "new business" rule. Indeed, we pointed out to the district court (App. 99):

> It is important to keep the point of Western's summary judgment in sharp focus. It is that the New Business Rule prevents MindGames from proving "lost profits" as a matter of law.

And further (App. 99): "On this motion we are not arguing the sufficiency of proof, but whether MindGames has the right to present proof."

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[3] Western's argument confuses "profits" with "sales" and is contrary to Arkansas law. See *Union National Bank of Little Rock v. Moshbacher*, 933 F.2d 1440 (8th Cir. 1991), *cert. den.*, 502 U.S. 1031 (1992) (Ark. law; established business can recover lost future profits despite recent loss history); *Jim Halsey Co., Inc. v. Bonar*, 683 S.W.2d 898 (Ark. 1985) (concert promoter can claim lost profits despite evidence of successful prior promotions); *Finley v. River North Records*, 148 F.3d 913 (8th Cir. 1998) (Ark. law; fledgling music concert promoter can recover lost future profits despite absence of any prior success).

III. The Majority Opinion Conflicts with Supreme Court Summary Judgment Precedent by Improperly Drawing Controlling Inferences Against MindGames.

The panel unanimously rejected the district court's ground for granting summary judgment. In affirming summary judgment nonetheless, the majority drew inferences against MindGames, the nonmoving party, and thus violated guidelines set by this Court.

Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (1986), mandates that "at the summary judgment stage the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial" and that "evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor." *Id.* at 255.

Overuse of Fed. R. Civ. P. 56 was previously recognized by the Seventh Circuit as infringing upon Seventh Amendment rights and causing meritorious cases to be dismissed without benefit of the record being developed at trial. It said in *Wallace v. SMC Pneumatics, Inc.*, 103 F.3d 1394, 1397 (7th Cir. 1997):

> The expanding federal caseload has contributed to a drift in many areas of federal litigation toward substituting summary judgment for trial. The drift is understandable, given caseload pressures that . . . sometimes make it difficult to find time for civil trials in the busier federal districts. But it must be resisted. . . ."

(Citations omitted.) *See also Door Systems, Inc. v. Pro-Line Door Systems, Inc.*, 83 F.3d 169, 172 (7th Cir. 1996), and JAMES W. MOORE, ET AL., MOORE'S FEDERAL PRACTICE § 56.50 at 56-313, -314 (3d ed. 1997).

The majority's decision here, however, disregards such concerns. It concludes without a trial, on a record limited to the "new business" rule issue, that MindGames would not be able to prove the volume of lost sales. In so doing, it not only disregarded the limitations on the record made below but also indulged in at least two critical anti-MindGames inferences.

First, after acknowledging a pro-MindGames inference that more games could have been sold if properly marketed by Western, the majority found "an equally if not more plausible possibility is that the reason Western didn't market the game more vigorously was that it correctly sensed that demand had dried up." App. 13.

It is unprecedented that the majority should divine Western's intent in not properly marketing *Clever Endeavor* and that demand for the game "dried up." Western presented no affidavit, no document, no deposition, no evidence of any kind to explain *why* Western mishandled the marketing of *Clever Endeavor*. Western itself did not presume to argue Western's "reasons." The first time this inference appeared in the case is in the majority's opinion, beyond any possible opportunity for MindGames to respond. *Anderson*, 477 U.S. at 255, forbids preferring, much less creating, such an anti-MindGames inference over the one favoring MindGames.

Moreover, no evidence was offered to support the majority's inference that "demand had dried up." Further,

the majority begs the question of why demand "dried up," assuming that happened. A jury could reject the "dried up demand" inference altogether or it could find that any "drying up" was the result of the breaches described in ¶¶ 26 and 27 of the Blackwell summary judgment affidavit (App. 90-93): confusion and dissatisfaction among retailers and consumers stemming from poorly printed and wrongly colored box wraps, defective board pieces, missing components (game rules, board pieces, venture cards), incorrectly cut and duplicated clue cards, failure to deliver promised TV ads, an unauthorized price increase, late TV ad campaigns, wrongly targeted radio ad campaigns, underspending on ads and other breaches. The majority also overlooked that Western gave promotion and sale preference to other games, very likely because they required it to pay much lower royalties. App. 93 (¶ 27j). Western itself did not believe demand for *Clever Endeavor* had dried up. Its 1991 annual report to stockholders stated that "*Clever Endeavor* . . . should enjoy significant sales in the coming year."

In holding that MindGames had not proved lost sales due to Western's breaches because it is "equally or more plausible" that "demand had dried up," the Court of Appeals clearly violated the summary judgment standard described in *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992), where this Court made clear that *Matsushita*'s requirement that the plaintiffs' claims make economic sense did not introduce a special burden on plaintiffs facing summary judgment, stating:

> The Court did not hold that if the moving party enunciates any economic theory supporting its behavior, regardless of its accuracy in

> reflecting the actual market, it is entitled to summary judgment. *Matsushita* demands only that the nonmoving party's inferences be reasonable in order to reach the jury, a requirement that was not invented, but merely articulated, in that decision. If the plaintiff's theory is economically senseless, no reasonable jury could find in its favor, and summary judgment should be granted.

Id. at 468-69 (footnote omitted).

As long as MindGames' damage evidence, when presented, is reasonable rather than "economically senseless," it is entitled to consideration. Its right to present evidence was cut off here. The Seventh Amendment right to a jury is indeed illusory in the Seventh Circuit if the Court of Appeals can select as between nearly "equal" inferences the one it believes is "more plausible," without having allowed an evidentiary record to be developed, particularly where MindGames had no notice of a need to develop such a record.

The majority's second unwarranted inference is that MindGames' failure to terminate its contract with Western and seek distribution of "Clever Endeavor" by other means ". . . is telling evidence of a lack of commercial promise unrelated to Western's conduct." App. 14. The majority overlooked evidence that Western destroyed MindGames' opportunity to seek other licensees by illegally dumping many thousands of copies of the game at less than 25% of its contractual wholesale price. *See* Blackwell Aff. ¶ 32 (App. 95).

Such oversights illustrate the hazard for the court and the potential for injustice for litigants when a court goes outside the issues developed below and in the appeal briefing to affirm.

Whether in the granting of summary judgment by a district court or the affirming of summary judgment by the court of appeals, judicial fact-finding and denying the nonmovant the benefit of permissible inferences conflicts with settled precedent from this Court. This Court should grant review to preserve the petitioner's right to a jury trial and to remind lower courts that the decisions in *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986), and *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), should not be read as weakening the prohibition against judicial fact-finding.

CONCLUSION

The thrust of this petition is illustrated by the following hypothetical:

P brings an antitrust, securities fraud or other complex tort action. D believes it has a good faith statute of limitations defense and would like to raise it early to avoid the expense of merits discovery. Rule 56 was obviously intended to allow D an immediate adjudication of its dispositive threshold defense.

That purpose is frustrated by the Seventh Circuit's application of Rule 56 because, in opposing summary judgment, neither P nor the district court can rely on a response limited to the time-bar issue. If the district court

dismisses the case as time-barred and P satisfies the court of appeals the case is not time-barred, the Seventh Circuit may nevertheless look to other issues and, if it finds one on which there is insufficient evidence, dismiss the case on that alternative ground.

To forestall such an outcome, P's initial response to the summary judgment motion must include evidence sufficient to make a *prima facie* case on all elements of its claim. Before considering the statute of limitations defense, the district court in turn must allow P sufficient time to take discovery on all elements of its claim. In short, the Seventh Circuit's *de facto* disregard of *Celotex*'s notice requirement has not only vitiated MindGames' constitutional rights to a trial but destroys the efficacy of Rule 56 itself.

This court should take this case (1) to establish the criteria for the notice and hearing required regarding summary judgments on alternative grounds not raised by movants and (2) to rein in the tendency of the appeals court to draw improper inferences on summary judgment appeals in contravention of the right to a civil jury trial.

Respectfully submitted,

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No. 00-825

In the
Supreme Court of the United States

OCTOBER TERM 2000

MINDGAMES, INC.

Petitioner,

v.

WESTERN PUBLISHING COMPANY, INC.

Respondent.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the

United States Court of Appeals

For the Seventh Circuit

No. 98-1879

MINDGAMES, INC.

Plaintiff-Appellant,

v.

WESTERN PUBLISHING COMPANY, INC.,

Defendant-Appellee.

Appeal from the United States District Court
for the Eastern District of Wisconsin.
Nos. 94 C 552, 94 C 998 -- **Lynn S. Adelman**, *Judge*

ARGUED APRIL 17, 2000--DECIDED JUNE 22, 2000
PETITION FOR REHEARING DENIED AUGUST 22, 2000

Before POSNER, *Chief Judge*, and FAIRCHILD and DIANE P. WOOD, *Circuit Judges*.

POSNER, *Chief Judge*. This is a diversity suit for breach of contract, governed by Arkansas law because of a choice of law provision in the contract. The plaintiff, MindGames, was formed in March of 1988 by Larry Blackwell to manufacture and sell an adult board game,

"Clever Endeavor," that he had invented. The first games were shipped in the fall of 1989 and by the end of the year, 75 days later, 30,000 had been sold. In March of 1990, MindGames licensed the game to the defendant, Western, a major marketer of games. Western had marketed the very successful adult board games "Trivial Pursuit" and "Pictionary" and thought "Clever Endeavor" might be as successful. The license contract, on which this suit is premised, required Western to pay MindGames a 15 percent royalty on all games sold. The contract was by its terms to remain in effect until the end of January 1993, or for another year if before then Western paid MindGames at least $1.5 million in the form of royalties due under the contract or otherwise, and for subsequent years as well if Western paid an annual renewal fee of $300,000.

During the first year of the contract, Western sold 165,000 copies of "Clever Endeavor" and paid MindGames $600,000 in royalties. After that, sales fell precipitously (though we're not told by how much) but the parties continued under the contract through January 31, 1994, though Western did not pay the $900,000 ($1.5 million minus $600,000) that the contract would have required it to pay in order to be entitled to extend the contract for a year after its expiration. In February of 1994 the parties finally parted. Later that year MindGames brought this suit, which seeks $900,000, plus lost royalties of some $40 million that MindGames claims it would have earned had not Western failed to carry out the promotional obligations that the contract imposed on it, plus $300,000 on the theory that Western renewed the contract for

a third year, beginning in February of 1994; Western sold off its remaining inventory of "Clever Endeavor" in that year.

The district court granted summary judgment for Western, holding that the contract did not entitle MindGames to a renewal fee and that Arkansas's "new business" rule barred any recovery of lost profits. 944 F. Supp. 754 (E.D. Wis. 1996); 995 F. Supp. 949 (E.D Wis. 1998). Although the victim of a breach of contract is entitled to nominal damages, *Mason v. Russenberger,* 542 S.W.2d 745 (Ark. 1976); *Movitz v. First Nat. Bank of Chicago,* 148 F.3d 760, 765 (7th Cir. 1998); E. Allan Farnsworth, *Contracts* § 12.8, p. 784 (3d ed. 1999), Mind Games does not seek them; and so if it is not entitled to either type of substantial damages that it seeks, judgment was correctly entered for Western. By not seeking nominal damages, incidentally, MindGames may have lost a chance to obtain significant attorneys' fees, to which Arkansas law entitles a prevailing party in a breach of contract case. See *Dawson v. Temps Plus, Inc.*, 987 S. W.2d 722, 729 (Ark. 1999).

The rejection of MindGames' claim to the renewal fee for the second year (and *a fortiori* the third) was clearly correct. The contract conditioned Western's right to renew the contract for a second year on its paying a renewal fee of $1.5 million (minus royalties already paid); it was silent on the terms of a renewal adopted by a new agreement of the parties rather than by the exercise of an option granted by the original contract. If MindGames hadn't wanted to renew the contract and Western had insisted, then Western would have had to pay the fee. But if Western did not invoke a

contractual right to renew, if instead the parties entered into a new agreement to renew the contract, then MindGames had no right to the renewal fee fixed in the contract; that right was *conditional* on Western's exercising its contractual right to renew. A conditional right in a contract does not become an enforceable right until the condition occurs, *Restatement (Second) of Contracts* § 225(1) (1981), unless noncompliance with the condition is excused by agreement, *Uebe v. Bowman*, 420 S.W.2d 889 (Ark. 1967); *Normand v. Orkin Exterminating Co.*, 193 F.3d 908,912 (7th Cir. 1999), or by operation of law, Farnsworth, *supra* § 8.3, p. 526, as where the other party to the contract wrongfully prevents the condition from occurring, *id.*, §8.6, pp. 544-45; *Restatement, supra*, § 225, comment b, which is not alleged, for Western had no duty to exercise its right of renewal. The condition that would have entitled MindGames to demand a renewal fee thus did not occur here; Western did not invoke its contractual right to extend the contract; after January 31,1993, the parties were operating under a new contract.

The more difficult issue is MindGames' right to recover lost profits for Western's alleged breach of its duty to promote "Clever Endeavor." A minority of states have or purport to have a rule barring a new business, as distinct from an established one, from obtaining damages for lost profits as a result of a tort or a breach of contract. E.g., *Lockheed Information Management Systems Co. v. Maximus, Inc.*, 524 S.E.2d 420, 429-30 (Va. 2000); *Bell Atlantic Network Services, Inc. v. P.M. Video Corp.*, 730 A.2d 406, 419-20 (N.J. Super. 1999); *Interstate Development Services of Lake Park, Georgia, Inc. v. Patel*, 463 S.E.2d 516 (Ga. App.

1995); *Stuart Park Associates Limited Partnership v. Ameritech Pension Trust,* 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law); Bernadette J. Bollas, Note, "The New Business Rule and the Denial of Lost Profits," 48 *Ohio St. L.J.* 855, 859 & n. 32 (1987). The rule of *Hadley v. Baxendale,* 9 Ex. 341, 156 Eng. Rep. 145 (1854), often prevents the victim of a breach of contract from obtaining lost profits, but that rule is not invoked here. Neither the "new business" rule nor the rule of *Hadley v. Baxendale* stands for the *general* proposition that lost profits are never a recoverable item of damages in a tort or breach of contract case.

Arkansas is said to be one of the "new business" rule states on the strength of a case decided by the state's supreme court many years ago. The appellants in *Marvell Light & Ice Co. v. General Electric Co.,* 259 S.W. 741 (Ark. 1924), sought to recover the profits that they claimed to have lost as a result of a five and a half month delay in the delivery of icemaking machinery; the delay, the appellants claimed, had forced them to delay putting their ice factory into operation. The court concluded, however, that because there was no indication "that the manufacture and sale of ice by appellants was an established business so that proof of the amount lost on account of the delay. . . might be made with reasonable certainty," "the anticipated profits of the new business are too remote, speculative, and uncertain to support a judgment for their loss." It quoted an earlier decision in which another court had said that "he who is prevented from embarking in [*sic* -- must mean 'on'] a new business can recover no profits, because there are no provable data of past business from which the fact that anticipated profits would have been

realized can be legally deduced." *Central Coal & Coke Co. v. Hartman,* 111 Fed. 96, 99 (8th Cir. 1901). That quotation is taken to have made Arkansas a "new business" state, although the rest of the *Marvell* opinion indicates that the court was concerned that the anticipated profits of the *particular* new business at issue, rather than of every new business, were too speculative to support an award of damages. On its facts, moreover, *Marvell* was a classic *Hadley v. Baxendale* type of case -- in fact virtually a rerun of *Hadley,* except that the appellants alleged that they had notified the seller of the icemaking machinery of the damages that they would suffer if delivery was delayed, and the seller had agreed to be liable for those damages. The decision is puzzling in light of that allegation; it is doubly puzzling because, assuming that by the time of the trial the ice factory was up and running, it should not have been difficult to compute the damages that the appellants had lost by virtue of the five and a half month delay in placing the factory in operation. Presumably it would have had five and a half months of additional profits.

Marvell has never been overruled; and federal courts ordinarily take a nonoverruled decision of the highest court of the state whose law governs a controversy by virtue of the applicable choice of law rule to be conclusive on the law of the state. E.g., *Milwaukee Metropolitan Sewerage District v. Fidelity & Deposit Co.,* 56 F.3d 821, 823 (7th Cir. 1995); *C & B Sales & Service, Inc. v. McDonald,* 111 F.3d 27,29 n.1 (5th Cir. 1997); *New York Life Ins. Co. v. K N Energy, Inc.,* 80 F.3d 405,409 (10th Cir. 1996). But this is a matter of practice or presumption, not of rule. The rule is that in a

case in federal court in which state law provides the rule of decision, the federal court must predict how the state's highest court would decide the case, and decide it the same way. *Treco, Inc. v. Land of Lincoln Savings & Loan,* 749 F.2d 374, 377 (7th Cir. 1984); *New Hampshire Ins. Co. v. Vieira,* 930 F.2d 696, 701 (9th Cir. 1991); 19 Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice and Procedure* § 4507, pp. 126-50 (2d ed. 1996). Law, Holmes said, in a controversial definition that is, however, a pretty good summary of how courts apply the law of other jurisdictions, is just a prediction of what the courts of that jurisdiction would do with the case if they got their hands on it. Oliver Wendell Holmes, "The Path of the Law ," 10 *Harv. L. Rev.* 457, 461 (1897). Since state courts like federal courts do occasionally overrule their decisions, there will be occasional, though rare, instances in which the best prediction of what the state's highest court will do is that it will *not* follow its previous decision. See, e.g., *Burgess v. Lowery,* 201 F.3d 942, 948 (7th Cir. 2000); *Treco, Inc. v. Land of Lincoln Savings & Loan, supra,* 749 F.2d at 377; *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153,1176 (3d Cir. 1993); 19 Wright, Miller & Cooper, *supra,* § 4507, pp. 141-49.

That is the best prediction in this case. *Marvell* was decided more than three quarters of a century ago, and the "new business" rule which it has been thought to have announced has not been mentioned in a published Arkansas case since. The opinion doesn't make a lot of sense on its facts, as we have seen, and the Eighth Circuit case on which it relied has long been superseded in that circuit. See, e.g., *Central Telecom,munications, Inc. v. TCI Cablevision, Inc.,*

800 F.2d 711, 727-28 (8th Cir. 1986). The Arkansas cases decided since *Marvell* that deal with damages issues exhibit a liberal approach to the estimation of damages that is inconsistent with a flat rule denying damages for lost profits to all businesses that are not well established. *Jim Halsey Co. v. Bonar,* 683 S.W.2d 898, 902-03 (Ark. 1985); *Tremco, Inc. v. Valley Aluminum Products Corp.,* 831 S.W.2d 156, 158 (Ark. App. 1992); *Ozark Gas Transmission Systems v. Barclay,* 662 S.W.2d 188, 192 (Ark. App. 1983); J.W. Looney, "The 'New Business Rule' and Breach of Contract Claims for Lost Profits: Playing Mindgames with Arkansas Law," 1997 *Ark. L. Notes* 43, 46-47. The *Ozark* decision, for example, allowed an orchard farmer to recover for the damages to a *new* orchard. The "new business" rule has, moreover, been abandoned in most states that once followed it, e.g., *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin,* 717 A.2d 724, 733-35 (Conn. 1998); *AGF, Inc. v. Great Lakes Heat Treating Co.,* 555 N.E.2d 634, 637-39 (Ohio 1990); *No Ka Oi Corp. v. National 60 Minute Tune, Inc.,* 863 P.2d 79, 81-82 (Wash. App. 1993); *Orchid Software, Inc. v. Prentice-Hall, Inc.,* 804 S.W.2d 208, 210-11 (Tex. App. 1991); *Beck v. Clarkson,* 387 S.E.2d 681, 683-84 (S.C. App. 1989); see also *McNamara v. Wilmington Mall Realty Corp,* 466 S.E.2d 324, 330 (N.C. App. 1996); *International Telepassport Corp. v. USFI, Inc.,* 89 F.3d 82, 85-86 (2d Cir. 1996) (per curiam) (New York law); *Restatement, supra,* § 352, comment b, and it seems to retain little vitality even in states like Virginia, which purport to employ the hard-core per se approach. See *Commercial Business Systems, Inc. v. Bellsouth Services, Inc.,* 453 S.E.2d 261, 268-69 (Va. 1995);

see generally *Eljer Mfg., Inc. v. Kowin Development Corp.*, 14 F.3d 1250, 1256 (7th Cir. 1994).

Western tries to distinguish *Ozark* by pointing to the fact that the plaintiff there was an established orchard farmer, albeit the particular orchard represented a new venture for him. This effort to distinguish that case brings into view the primary objection to the "new business" rule, an objection of such force as to explain its decline and make it unlikely that Arkansas would follow it if the occasion for its supreme court to choose arose. The objection has to do with the difference between *rule* and *standard* as methods of legal governance. A rule singles out one or a few facts and makes it or them conclusive of legal liability; a standard permits consideration of all or at least most facts that are relevant to the standard's rationale. A speed limit is a rule; negligence is a standard. Rules have the advantage of being definite and of limiting factual inquiry but the disadvantage of being inflexible, even arbitrary, and thus overinclusive, or of being underinclusive and thus opening up loopholes (or of being *both* over and underinclusive!). Standards are flexible, but vague and open-ended; they make business planning difficult, invite the sometimes unpredictable exercise of judicial discretion, and are more costly to adjudicate -- and yet when based on lay intuition they may actually be more intelligible, and thus in a sense clearer and more precise, to the persons whose behavior they seek to guide than rules would be. No sensible person supposes that rules are always superior to standards, or vice versa, though some judges are drawn to the definiteness of rules and others to the flexibility of standards. But that is psychology; the important point is that some activities are

better governed by rules, others by standards. States that have rejected the "new business" rule are content to control the award of damages for lost profits by means of a standard -- damages may not be awarded on the basis of wild conjecture, they must be proved to a reasonable certainty, e.g., *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin, supra,* 717 A.2d at 733-34; *AGF, Inc. v. Great Lakes Heat Treating Co., supra,* 555 N .E.2d at 638-39, that is applicable to proof of damages generally. See, e.g., *Jones Motor Co. v. Holtkilmp, Liese, Beckemeier & Childress, P.C.,* 197 F.3d 1190, 1194-95 (7th Cir. 1999), and cases cited there; *Ashland Management Inc. v. Janien,* 624 N.E.2d 1007, 1010 (N.Y. 1993); *Restatement, supra,* § 352. The "new business" rule is an attempt now widely regarded as failed to control the award of such damages by means of a rule.

The rule doesn't work because it manages to be at once vague and arbitrary. One reason is that the facts that it makes determinative, "new," "business," and "profits," are not facts, but rather are the conclusions of a reasoning process that is based on the rationale for the rule and that as a result turns the rule into an implicit standard. What, for example, is a "new" business? What, for that matter, is a "business"? And are royalties what the rule means by "profits"? MindGames was formed more than a year before it signed the license agreement with Western, and it sold 30,000 games in the six months between the first sales and the signing of the contract. MindGames' only "business," moreover, was the licensing of intellectual property. An author who signs a contract with a publisher for the publication of his book would not ordinarily be regarded as being engaged in a "business," or his royalties

or advance described as "profits." He would be surprised to learn that if he sued for unpaid royalties he could not get them because his was a "new business." Suppose a first-time author sued a publisher for an accounting, and the only issue was how many copies the publisher had sold. Under the "new business" rule as construed by Western, the author could not recover his lost royalties even though there was no uncertainty about what he had lost. So construed and applied, the rule would have no relation to its rationale, which is to prevent the award of speculative damages.

Western goes even further, arguing that even if it, Western, a well-established firm, were the plaintiff, it could not recover its lost profits because the sale of "Clever Endeavor" was a new business. On this construal of the rule, "business" does not mean the enterprise; it means any business activity. So Western's sale of a new game is a new business, yet we know from the *Ozark* decision that an orchard farmer's operation of a new orchard is an old business.

The rule could be made sensible by appropriate definition of its terms, but we find it hard to see what would be gained, given the existence of the serviceable and familiar standard of excessive speculativeness. The rule may have made sense at one time; the reduction in decision costs and uncertainty brought about by avoiding a speculative mire may have swamped the increased social costs resulting from the systematically inadequate damages that a "new business" rule decrees. But today the courts have become sufficiently sophisticated in analyzing lost-earnings claims, and have accumulated sufficient precedent on the standard of undue

speculativeness in damages awards, to make the balance of costs and benefits tip against the rule. In any event we are far in this case, in logic as well as time, from the ice factory whose opening was delayed by the General Electric Company. We greatly doubt that there is a "new business" rule in the common law of Arkansas today, but if there is it surely does not extend so far beyond the facts of the only case in which the rule was ever invoked to justify its invocation here. There is no authority for, and no common sense appeal to, such an extension.

But that leaves us with the question of undue speculation in estimating damages. Abrogation of the "new business" rule does not produce a free-for-all. What makes MindGames' claim of lost royalties indeed dubious is not any "new business" rule but the fact that the success of a board game, like that of a book or movie, is so uncertain. Here newness enters into judicial consideration of the damages claim not as a rule but as a factor in applying the standard. Just as a start-up company should not be permitted to obtain pie-in-the-sky damages upon allegations that it was snuffed out before it could begin to operate (unlike the ice factory in *Marvell,* which did begin production, albeit a little later than planned), capitalizing fantasized earnings into a huge present value sought as damages, so a novice writer should not be permitted to obtain damages from his publisher on the premise that but for the latter's laxity he would have had a bestseller, when only a tiny fraction of new books achieve that success. Damages must be proved, and not just dreamed, though "some degree of speculation is permissible in computing damages, because reasonable doubts as to remedy ought to be resolved

against the wrongdoer." *Jones Motor Co. v. Holtkamp, Liese, Beckemeier & Childress, P.C., supra,* 197 F.3d at 1194; see *Restatement, supra,* § 352, comment a.

This is not to suggest that damages for lost earnings on intellectual property can never be recovered; that "entertainment damages" are not recoverable in breach of contract cases. That would just be a variant of the discredited "new business" rule. What is important is that Blackwell had no track record when he created "Clever Endeavor." He could not point to other games that he had invented and that had sold well. He was not in the position of the bestselling author who can prove from his past success that his new book, which the defendant failed to promote, would have been likely -- not certain, of course -- to have enjoyed a success comparable to that of the average of his previous books if only it had been promoted as promised. That would be like a case of a new business launched by an entrepreneur with a proven track record.

In the precontract sales period and the first year of the contract a total of 195,000 copies of "Clever Endeavor" were sold; then sales fizzled. The public is fickle. It is possible that if Western had marketed the game more vigorously, more would have been sold, but an equally if not more plausible possibility is that the reason that Western didn't market the game more vigorously was that it correctly sensed that demand had dried up.

Even if that alternative is rejected, we do not see how the number of copies that would have been sold but for the

alleged breach could be determined given the evidence presented in the summary judgment proceedings (a potentially important qualification, of course); and so MindGames' proof of damages is indeed excessively speculative. See, e.g., *Gentry v. Little Rock Road Machinery Co.*, 339 S.W.2d 101, 104 (Ark. 1960); *Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410, 1414 (8th Cir. 1995); *K & R, Inc. v. Crete Storage Corp.*, 231 N.W.2d 110, 115 (Neb. 1975); see also *AGF, Inc. v. Great Lakes Heat Treating Co., supra,* 555 N.E.2d at 640. Those proceedings were completed with no evidence having been presented from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter some broad but bounded range of alternative estimates, of copies of "Clever Endeavor" would have been sold had Western honored the contract. Mind Games obtained $600,000 in royalties on sales of 165,000 copies of the game, implying that Western would have had to sell more than 10 million copies to generate the $40 million in lost royalties that MindGames seeks to recover. Cf. *Boxhorn's Big Muskego Gun Club, Inc. v. Electrical Workers Local494,* 798 F.2d 1016, 1023 (7th Cir. 1986).

When the breach occurred, MindGames should have terminated the contract and sought distribution by other means. See Farnsworth, *supra,* § 12.12, pp. 806-08. The fact that it did not do so -- that so far as appears it has made no effort to market "Clever Endeavor" since the market for the game collapsed in 1991 -- is telling evidence of a lack of commercial promise unrelated to Western's conduct.

Although Western in its brief in this court spent most of its time misguidedly defending the "new business" rule, clinging to *Marvell* for dear life (a case seemingly on point, however vulnerable, is a security blanket that no lawyer feels comfortable without), it did argue that in any event MindGames' claim for lost royalties was too speculative to ground an award of damages for that loss. The argument was brief but not so brief as to fail to put MindGames on notice of a possible alternative ground for upholding the district court's judgment; we may of course affirm an award of summary judgment on any ground that has not been forfeited or waived in the district court. *United States v. Jackson,* 207 F.3d 910, 917 (7th Cir. 2000). MindGames did not respond to the argument in its reply brief. It pointed to no evidence from which lost royalties could be calculated to even a rough approximation. We find its silence eloquent and Western's argument compelling, and so the judgment in favor of Western is

AFFIRMED.

FAIRCHILD, *Circuit judge,* dissenting in part. I agree that (1) MindGames' claim for a renewal fee for the year following the initial term of the Licensing Agreement was properly dismissed, and (2) we are not bound by *Marvell Light & Ice Co. v. General Electric Co.,* 259 S.W. 741 (Ark. 1924) to affirm the dismissal of MindGames' claim for loss of royalties caused by breach of contract. I do, however, respectfully disagree with the conclusion that, as a matter of law, that claim is too speculative to support an award of damages.

This was never a claim in which MindGames sought to recover lost profits from the operation of a business. The damages sought would be measured by the royalties which Western would have been obliged to pay on sales which did not occur because of Western's alleged failure to perform its contract. Western's obligation to pay royalties arose from the sales of games manufactured, promoted and sold by it, and whether MindGames showed a profit, as well as MindGames' lack of history, was wholly irrelevant. The ultimate questions would be whether there was a breach by Western and whether the breach caused a loss of sales.

Sales did not meet expectations. In the period from March 30, 1990 to January 31,1991, 165,000 games were sold; in the year ending January 31, 1992, 58,113; in the year ending January 31, 1993, 26,394; and in the year after the initial term, 7,438. The sales in the initial term totaled approximately $4,000,000 and royalties $600,000. Soon after January 31, 1993, Western was sufficiently interested in continuing as licensee to agree to pay a minimum royalty of $27,500 for the coming year. MindGames' complaint alleged that a substantial number of games produced by Western failed to meet quality standards; Western failed to promote and make reasonable efforts to sell; and its efforts did not meet standards under the agreement or those recognized in the industry. It is MindGames' position that these failures caused loss of sales.

Western's motion for partial summary judgment was premised on the new business rule which Western perceived as announced in *Marvell,* and the district court granted the motion on that basis. If, as we all agree, *Marvell* does not

control this case, then the applicable Arkansas doctrine is that MindGames is entitled to recover any royalties on sales which MindGames can prove to a reasonable certainty would have been made had Western carried out the contract. The rule that damages which are uncertain cannot be recovered does not apply to uncertainty as to the value of the benefits to be derived, but to uncertainty as to whether any benefit would be derived at all. *Jim Halsey Co., Inc. v. Bonar,* 284 Ark. 461, 467-68 (Ark. 1985); *Crow v. Russell,* 226 Ark. 121, 123 (Ark. 1956).

In my opinion we cannot say on this record, as a matter of law, that MindGames can not prove to a reasonable certainty that Western's failures to perform, if proved, caused a loss of sales.

I would not hold that MindGames has waived or forfeited its opportunity to produce evidence of damages. It is true that in responding to Western's motion for partial summary judgment MindGames did not provide evidentiary material tending to show the breaches by Western nor that such breaches caused a loss of sales. This should not be deemed a waiver or forfeiture of an opportunity to do so because of Western's complete reliance in its motion on the new business rule and *Marvell,* which, if applied, would prevent proof of breach and causation of loss. Western's motion did not reach the issue of breach, and establishing damages would require MindGames to prove that the breach occurred and caused loss of sales. Although Western, in its memorandum in support of its motion did include a section making the point that the success of a new product in the

entertainment industry is especially difficult to predict, it used that point to support an argument that the new business rule was particularly appropriate in this case, and that the Arkansas Supreme Court would be unlikely to retreat from the new business rule under circumstances like these. Western did not squarely assert, as an alternative ground, that MindGames could not prove to a reasonable certainty that any breach by Western caused loss of sales. Rather, Western urged that the district court should strictly apply the new business rule.

In this court, Western again relied on *Marvell* and the new business rule, also arguing, as it had in the district court, that this type of case, involving a new product in the entertainment industry, is not one where the Arkansas Supreme Court would retreat from its application of the new business rule. Although at pages 30-32 of its brief it asserted the inherently speculative nature of a claim for lost profits in the entertainment industry, and cited cases, it failed squarely to assert, as an alternative ground, that its alleged failures to perform, if proved, could not have been proved to a reasonable certainty to have caused lost sales. On page 5 of its reply brief, MindGames referred to pages 29-32 of Western's brief, and challenged as contrary to Arkansas law "non-Arkansas cases [cited by Western] in arguing that businesses in the entertainment industry are barred *per se* from claimmg lost profits." Again I do not think it is appropriate to rely on waiver or forfeiture.

I would remand for further proceedings on this part of MindGames' complaint.

A true Copy:

Teste:

_____

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.

Plaintiff,

vs. **Case Number: 94-C-552**

MINDGAMES, INC.,

Defendant.

Consolidated With

MINDGAMES, INC.,

Plaintiff,

vs. **Case Number: 94-C-998**

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

DECISION AND ORDER

Before the Court is Western Publishing Company, Inc.'s ("Western") Motion for Partial Summary Judgment and Motion to Strike. For the following reasons, the Court holds that MindGames, Inc. ("MindGames") is hereby prevented from recovering damages for expected lost profits from a licensing agreement with Western under Arkansas law. Therefore, Western's Motion for Partial Summary Judgment is GRANTED and Motion to Strike is DENIED.

I. BACKGROUND

This litigation results from a disputed licensing agreement between MindGames, the licensor, and Western the licensee. MindGames seeks lost profits and compensatory damages from an alleged breach of the licensing agreement. Western now files a motion for partial summary judgment, seeking to prevent MindGames, as a matter of law, from recovering lost anticipated profits stemming from the alleged breach.

In March 1988, G. Lawrence Blackwell, III formed MindGames to promote and sell a new board game he had created called *Clever Endeavor. Mr.* Blackwell believed that *Clever Endeavor* would reach the popularity achieved by games such as *Pictionary and Trivial Pursuit.* After selling 30,000 copies of the game in 1989, Mr. Blackwell decided to enter into a licensing agreement with Western and Games Gang, Inc. ("Games Gang"). Under the terms of the agreement, Western and Games Gang planned to market, manufacture, promote, distribute and sell *Clever Endeavor.* Blackwell and MindGames would receive royalties on the number of games sold. Net sales for *Clever Endeavor in*

1990, the first year of the agreement, totalled 165,000, but fell off dramatically starting in 1991, until late 1993 when Western drastically reduced prices to eliminate excess stock of the game.

In 1994, MindGames brought suit for breach of the marketing agreement. Among other damages, MindGames seeks $40 million as lost profits that they believe the game would have realized had it been marketed correctly. Western now brings a motion for partial summary judgment on the issue of the lost profits. Western claims that the "New Business Rule," which prevents new and unestablished business ventures from collecting lost profits as damages in breach of contract or tort cases, guides this case as a matter of law, and mandates partial summary judgment in Western's favor. The Court now addresses Western's motion.[1]

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[1]Western has also filed a Motion to Strike the affidavit of Mr. Blackwell. Motions to strike are generally disfavored and information "will not be stricken unless it is evident that it has no bearing upon of the subject matter of the litigation." Securities and Exchange Commission v. Jos. Schlitz Brewing Co., 452 F. Supp. 824, 833,(E.D. Wis. 1978) (quoting Van Dyke Ford, Inc. v. Ford Motor Co., 399 F. Supp. 277 (E.D. Wis. 1975). Both parties have submitted information that is irrelevant on the legal issue before the Court: whether Arkansas law allows a new business to recover lost profits. Nonetheless, the Court having considered the affidavit of Mr. Blackwell, concludes for the reasons that follow that there are no disputed issues of material fact precluding awarding partial summary judgment to Western. Therefore, Western's Motion to Strike is **DENIED.**

II. LEGAL STANDARD

Summary judgment is no longer disfavored under the Federal Rules of Civil Procedure. See Celotex Corp. v. Catrett, 477 U.S. 317, 327 (1986) ("Summary judgment procedure is properly regarded as an integral part of the Federal Rules as a whole which are designed to 'secure the just, speedy and inexpensive determination of every action.'"). Federal Rule of Civil Procedure 56 requires a District Court to grant summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). The mere existence of some factual dispute does not defeat a summary judgment motion; "the requirement is that there is a genuine issue of material fact." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). For a dispute to be genuine, the evidence must be such that a "reasonable jury could return a verdict for the nonmoving party." Id. For the fact to be material, it must relate to a disputed matter that "might affect the outcome of the suit." Id.

The party moving for summary judgment bears the initial burden of showing that there are no material facts in dispute and that judgment should be entered in its favor. Hannon v. Turnage, 892 F.2d 653, 656 (7th Cir. 1990), cert. denied, 498 U.S. 821 (1990). A defendant moving for summary judgment may satisfy this initial burden by pointing to a plaintiff's failure to introduce sufficient evidence to support each essential element of the cause of action alleged. Anderson, 477 U.S. at 256; Celotex, 477 U.S. at 323-24. A

party opposing a properly supported summary judgment motion "may not rest upon mere allegations or denials," but rather must introduce affidavits or other evidence to "set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). See also Celotex, 477 U.S. at 322-23; Becker v. Tenenbaum-Hill Assoc., Inc., 914 F.2d 107, 110 (7th Cir. 1990). "If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party." Fed. R. Civ. P. 56(e).

In evaluating a motion for summary judgment, the Court must draw all inferences in a light most favorable to the non-moving party. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986); Johnson v. Pelker, 891 F.2d 136, 138 (7th Cir. 1989). "However, we are not required to draw every conceivable inference from the record -- only those inferences that are reasonable." Bank Leumi Le-Israel, B.M. v. Lee, 928 F.2d 232, 236 (7th Cir. 1991) (citations omitted.)

III. ANALYSIS

A. The New Business Rule as Valid Law

In general, when any business tries to recover lost profits in a breach of contract action, it must prove that the profits would have occurred with "reasonable certainty" but for the actions of the party in breach. American Fidelity Fire Ins. Co. v. Kennedy Bros. Constr., Inc., 282 Ark. 545, 670 S.W.2d 798 (1984). When the company seeking damages is a new business, the burden of proof to establish "reasonable certainty" rises considerably. Some states completely prevent the recovery of any profits in a new business situation. This

prevention of recovery is referred to as the "New Business Rule," currently under dispute in the litigation before this Court.

The Eighth Circuit in Hillside Enterprises v. Carlisle Corp., 69 F.3d 1410 (8th Cir. 1995) (wine marketer sued disposable wine glass manufacturer for lost profits after manufacturer failed to ship specifically ordered number of glasses that marketer was to use in "wine-in-a-glass" venture) cites Ferrell Constr. Co. v. Russell Creek Coal Co., 645 P.2d 1005, 1009-10 (Okla. 1982) as an example that would satisfy this newer, higher burden of proof of lost profits. The Hillside court notes that the plaintiffs, in Ferrell were coal mining for a finite amount of steel when the breach of contract occurred. The amount of steel limited the profits that the plaintiff should have achieved, making the profits easily discernible and relatively certain. Hillside, 69 F.3d at 1414. Had such a definite order not been present, the plaintiff would not have satisfied its requisite burden of certainty.

Many states adhere to the above-described approach when determining whether to award lost profits for a new business. States in the Eighth Circuit, like Missouri (Handi Caddy, Inc. v. American Home Products Corp., 557 F.2d 136 (8th Cir. 1977)) and Iowa (Harsha v. State Sav. Bank, 346 N.W.2d 791 (Iowa 1984)) recognize that the enforcement of any type of "New Business Rule" lies in the uncertainty of proving profits. With ample evidence of certainty, those states will allow evidence of lost profits to factor into the determination of damages awards. Minnesota takes the most liberal approach to this concept. Minnesota law (La Societe Immobiliere v. Minneapolis Community Dev. Agency, 827 F.

Supp. 1431 (D.Minn. 1993) *rev'd on other grounds,* 44 F.3d 629 (8th Cir. 1994) and Leoni v. Bemis Co., 255 N.W.2d 824 (Minn. 1977)) emphasizes the lack of a *per se* rule in favor of preventing new businesses from collecting anticipated profits. The state willingly allows evidence of lost profits into court, and, according to Olson v. Rugloski, 277 N.W.2d 385, 388 (Minn. 1979), requires the plaintiff to prove only reasonable certainty, not absolute certainty, to recover lost profits. Other states, such as Ohio and Michigan, have abandoned the *per se* "New Business Rule" in favor of a slightly more liberal approach that allows the party seeking damages an opportunity to prove those damages. See Fera v. Village Plaza, Inc., 242 N.W.2d 372, 376 (Mich. 1976); AGF, Inc. v. Great Lake Heat Treating Co., 555 N.E.2d 634, 638-39 (Ohio 1990).

At the minimum, even states that have now abandoned a *per se* approach to the "New Business Rule" will require plaintiffs to prove, with the certainty seen in Hillside, that the profits in question would have occurred before they may recover. The higher burden of proof is considered a rigorous standard of certainty to meet. The Southern District of New York, a state that allows recovery for lost profits in certain cases, gives the most succinct reason for making recovery of lost profits of a new business venture extremely difficult to achieve. The New York court, stated:

> The prospective profits of a new business or enterprise are regarded as being too remote, contingent, and speculative to meet the legal standard of reasonable certainty in determining the elements of recoverable damages in an action for breach of contract or for a tort.

International Minerals and Resources, Inc. v. Pappas, 761 F. Supp. 1068, 1079 (S.D.N.Y. 1991) (quoting 36 N.Y.Jur.2d Damages § 110, at 193-94 (1984)), *vacated on other grounds*, --- F.3d ---, 1996 WL 506612 (2d Cir. Sept. 6, 1996).

In addition, this dispute arises out of the entertainment industry which further reduces the certainty of MindGames' profits, making it more difficult to justify an award of lost profits. Even in states which do not adopt the strict application of the "New Business Rule," such as New York, the influence of the entertainment industry does not go unnoticed. In Kenford Co. v. County of Erie, 493 N.E.2d 234, 236 (N.Y. 1986), the New York Court of Appeals, in upholding the Superior Court's remittitur of a jury award for lost profits, noted the difficulty in establishing reasonable certainty for a new business. The court also found that the nature of the dispute (claiming lost profits from what would have been a sports stadium) increased uncertainty, stating, "New York has long recognized the inherent uncertainties of predicting profits in the entertainment field in general." Id. The Second Circuit echoed the Kenford decision in Proteus Books Ltd. v. Cherry Lane Music, 873 F.2d 502 (2d Cir. 1989). The court quoted Kenford's assessment of the entertainment industry's effect on the uncertainty of profits in its case dealing with a book publishing dispute. Proteus, 873 F.2d at 510.

As noted earlier, some states still accept the "New Business Rule" as *a per se* measure to completely prevent the recovery of any profits. See Stuart Park Associates Limited Partnership v. Ameritech Pension Trust, 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law); Springwill Dispensers, Inc. v.

Hall.China Co., 419 S.E.2d 112 (Ga. App. 1992) (Georgia law); Murray v. Hadid, 385 S.E.2d 898, 905 (Va. 1989) (Virginia law). Arkansas, the state whose law guides this case, still views the "New Business Rule" as a *per se* rule prohibiting the recovery of lost profits in a new business venture.

Based on its limited amount of case law, the state of Arkansas follows the "New Business Rule" strictly in preventing any recovery of lost profits. In Marvell Light & Ice Co. v. General Electric Co., 162 Ark. 467, 259 S.W. 741 (1924), the only Arkansas case addressing the "New Business Rule," General Electric brought suit against Marvell Light to recover over $700 for machinery sold to Marvell Light for assistance in constructing an ice plant. Marvell Light counterclaimed for profits lost during General Electric's delayed delivery of machinery. In sustaining General Electric's demurrer to the counterclaim, the Supreme Court of Arkansas stated, "anticipated profits of the new business are too remote, speculative, and uncertain to support a judgment for their loss." Marvell Light, 259 SW. at 741.

MindGames claims that Marvell Light is no longer good law because it is "a seventy-two-year-old procrustean case" that has not been followed since its outcome, and it has been eroded away by more recent Arkansas cases. Although Marvell Light has not been cited, it has not been overruled, and therefore, it remains good law. In addition, none of the cases cited by MindGames for its legal proposition involve a new business. According to MindGames, 555 Incorporated v. Leming, 45 S.W.2d 18 (Ark. 1932); Jim Halsey Co. v. Bonar, 683 S.W.2d 898 (Ark, 1985); Tremco, Inc. v. Valley

Aluminum Products Corp., 831 S.W.2d 156 (Ark. App. 1992); and Union National Bank of Little Rock v. Mosbacher, 933 F.2d 1440 (8th Cir. 1991), cert. denied, 502 U.S. 1031 (1992), all supposedly erode the Arkansas Supreme Court's decision in Marvell Light. However, the parties seeking damages in these above-cited cases are established businesses, and consequently, their influence in the case herein is minimal. For example, in Union National Bank, the Eighth Circuit acknowledged that courts can award lost profits to businesses that prove those profits would have occurred with "reasonable certainty." Union National Bank, 933 F.2d at 1444. However, Union National Bank involved a furniture company that had been in existence for over forty years at the time it filed suit. Certainly, the business in Union National Bank did not qualify as a "new business" subject to Marvell Light's rule.

Also, MindGames relies on 1 Dunn, Recovery of Damages for Lost Profits § 4.1 (4th ed. 1992) to argue that the "New Business Rule" is an "older rule" followed by a "diminishing number of states." (MindGames' Response at p. 8.) First, and foremost, a treatise, regardless of its persuasive value, is not law. Second, MindGames neglects to point out that Dunn expressly includes Arkansas as one of those "diminishing number" of states that still follow the "New Business Rule" and gives no indication that Arkansas will overrule their current position.

Decisions from the Seventh Circuit and Eastern District of Wisconsin detail how federal courts interpret state law and give further reasons for following Marvell Light. The Eastern District of Wisconsin, adhering to the seminal

decision of Erie R.R. v. Tompkins, 304 U.S. 64 (1938), states that. "[f]ederal courts in diversity actions are bound to accept the interpretations of state law by the state's highest court .... The Court's responsibility is to apply the relevant state law as it presently exists." Jaeger v. Raymark Industries, Inc., 610 F. Supp. 784, 787-88 (E.D. Wis. 1985); Midwest Helicopters Airways v. Sikorsky Aircraft, 849 F. Supp. 666, 668 (E.D. Wis.), *aff'd,* 42 F.3d 1391 (7th Cir. 1994). The Seventh Circuit reinforces this approach regarding the interpretation of state law by federal courts. See Kutsugeras v. Avco Corp., 973 F.2d 1341 (7th Cir. 1992) ("Under principles of Erie v. Tompkins [*Citation omitted*], a federal court must apply the state law as declared by the highest state court or otherwise by the intermediate appellate court of the state."). These principles clearly apply in this case where the parties brought suit solely pursuant to diversity jurisdiction. See Shaw v. Republic Drill Corp., 810 F.2d 149,.150 (7th Cir. 1987) ("[W]e have already indicated our unwillingness to speculate on any trends in state law. *[Citation omitted.]* This policy applies special force to a plaintiff in a diversity case who has chosen to litigate his state law claim in federal court."); Afram Export Corp. v. Metallurgiki Halyps, S.A., 772 F.2d 1358, 1370 (7th Cir. 1985) ("A party who wants a court to adopt an innovative rule of state law should litigate in state court. Federal judges are disinclined to make bold departures in areas of law that we have no responsibility for developing.").

MindGames suggests that we use the Third Circuit as a guide for how federal courts change state law. In In re Merritt Logan, Inc., 901 F.2d 349 (3d Cir. 1990), the Third Circuit considered then-current New Jersey law which

embraced *a per se* application of the "New Business Rule." The Court, in recognizing the recent trend of New Jersey cases and cases nationwide, overruled the old "New Business Rule" cases in favor of the modern approach to damages involving lost profits. Merritt Logan, 901 F.2d at 357.

However, two distinctions prevent the Court in the case herein from adopting the Third Circuit's approach to deciding the case. First, in Merritt Logan, New Jersey case law preceding the Merritt Logan decision had indicated an inkling to abandon the "New Business Rule." No recent Arkansas case has shown that Arkansas appears willing to discard the "New Business Rule." As previously discussed, all cases cited by MindGames involved established business gaining an opportunity to show damages. Second, the approach of the circuit courts vary in this field. The Third Circuit interpreted its role as "predict[ing] whether the New Jersey Supreme Court would follow the rule against giving a new business damages for lost profits if it were now presented with that issue in the context of this case." Id. Clearly, the Seventh Circuit does not use the same standard as the Third Circuit when interpreting state law. For the Court to do so in this case would result in a direct contradiction of controlling earlier cited Seventh Circuit law. In sum, the Court has no responsibility to expand or alter existing Arkansas state law.

Finally, in reference to the validity of the "New Business Rule," the Court notes a Seventh Circuit case cited by Western. In arguing against MindGames proposition that this Court follow others across the country and abandon the *per se* application of the "New Business Rule," Western points out the Seventh Circuit's attitude towards such judicial

activity: "Given that Florida law governs this case, the authorities from other jurisdictions cited and argued by the parties [citations omitted] are only indirectly relevant. Gust K. Newberg Constr. Co. v. E.H. Crump & Co., 818 F.2d 1363, 1368 n.7 (7th Cir. 1987). In conclusion, the decision in Marvell Light is the controlling law of Arkansas. For the case herein, Arkansas law governs, and Arkansas law accepts the "New Business Rule" *per se*.

B. Application of the "New Business Rule"

The Texas Court of Civil Appeals best describes what most courts look for as they distinguish between new and established businesses for purposes of applying the "New Business Rule." In Atomic Fuel Extraction Corp. v Slick, 386 S.W.2d 1-80, 189 (Tex.Ct.Civ.App. 1964), the court stated:

> An established business should be one that is in actual operation long enough to give it permanency and recognition. It should be one that has earned a profit which can be reasonably ascertained and approximated. . . . Proof of an operation of a business at a loss fails to meet the test.

The courts have used the duration of the business' existence and its record of profits to determine whether a corporation qualifies as a new business. See Delahanty v. First Pennsylvania Bank N.A., 464 A.2d 1243, 1261 (Pa. Super. Ct. 1983) (seven months of operation not enough of a record of profitability to sustain an award of damages for anticipated profits; the court hints that two years may have been enough);

McBrayer v. Teckla, Inc., 496 F. 2d 1 22 (5th Cir. 1974) (plaintiff not entitled to lost profits because he was only in operation for a little over nine months and had not achieved a profit in that time); Proteus Books, Ltd. v. Cherry Lane Music, 873 F.2d 502 (2d Cir. 1989) (company with two years of existence, but poor sales, still qualifies as a new business).

It appears that *Clever Endeavor* and MindGames both satisfy the two elements of the new business test. The licensing agreement that brought the parties in this suit together consummated in March of 1990. MindGames had been incorporated since March of 1988, and did not produce a product until 1989. The company decided to market the game (its sole product) in the spring of 1989, but it did not reach the market until September, 1989. (See Blackwell Dep. at pp. 24, 107, 168-69.) All told, *Clever Endeavor* was on the market for approximately six months before the licensing agreement began. Additionally, in those six months, MindGames did not turn a profit. (See Western's Brief in Support of its Motion for Partial Summary Judgment, Exh. B and G.) Because *Clever Endeavor* did not have an established record of profitability, and because it had such a short lifespan, it qualifies as a new business, subject to the application of the "New Business Rule."

C. MindGames' Arguments Against Using the "New Business Rule"

MindGames opposes the use of this rule because it believes *Clever Endeavor* had an established track record; because neither Western nor Games Gang was a new business; and because MindGames' royalties were pure profits.

MindGames' first argument has already been dismissed; as to the other two, they shall likewise be rejected. Whether Western or Games Gang qualifies as a new business is irrelevant in this case. When a court looks to award lost profits in any situation, it measures lost profits by the past profits of the party seeking the damages -- not the party that caused the damages. Every case cited by the Court supports this proposition. Similarly, in determining whether to apply the "New Business Rule," the court looks to the party seeking the profits to see whether or not that party is a new business. As the Supreme Court of Arkansas noted in Marvell Light, "He *who is prevented from embarking in a new business* can recover no profits because there are no provable data of past business from which the fact that anticipated profits would have been realized can be legally deduced." Marvell Light 259 S.W. at 741 (quoting Central Coal and Coke Co. v. Hartman, 111 Fed. 96, 49 C.C.A. 244) (emphasis added).

As a side note, the "New Business Rule" applies to new products sold by an existing business. See Stuart Park Associates, Ltd. v. Ameritech Pension Trust, 846 F. Supp. 701 (N.D. Ill. 1994), *aff'd,* 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law - "New Business Rule" state) (plaintiffs success with other apartment buildings did not yield damages for lost profits in a similar, but different real estate venture); Pennsylvania State Shopping Plazas, Inc. v. Olive 120 S.E.2d 372 (Va. 1961) (plaintiff had operated 14 service stations successfully, but opening a new one still constituted a new business). *Clever Endeavor* remained on the market for only six months prior to the licensing agreement, clearly making it a new product. Therefore, even if the Court would accept

MindGames' suggestion that the Court should measure the "New Business Rule" by Western and Games Gang, established businesses, the rule still applies in this case.

MindGames attempts to use a technicality to avoid the application of the "New Business Rule" to this case. The "New Business Rule" applies to parties seeking lost profits; MindGames claims it seeks lost *royalties,* rather than profits, and therefore, the "New Business Rule" does not apply to this case.

The Court sees this attempt by MindGames as a futile effort to avoid Arkansas case law. In MindGames' complaint, the company states that "[t]he breaches of the agreement by Western and Games Gang, Ltd. have caused substantial damages, both present and future, to MindGames, including loss of profits and interference with MindGames' business relations." (MindGames Complaint at ¶8.) In addition, in a February, 1996 letter from MindGames' counsel to Western's counsel, MindGames classified the damages sought as "lost future profits." (See Western's Reply Brief, Exh. D.) It appears that MindGames chose to make the distinction between profits and royalties only after realizing the strength of Western's "New Business Rule" defense.

Also, MindGames uses Corbin's definition of profits to attempt to prove the difference between profits and royalties. See 5 Corbin On Contracts § 1022, at 135-36 (1964) (profit is the full value of performance minus the cost of performance; MindGames argues that no cost of performance was taken away from the royalties, meaning it could not have been profits). In doing so, MindGames

neglects Black's Law Dictionary's definition of royalties: a "share of product or **profit** reserved by owner for permitting another to use the property." Black's Law Dictionary 1330 (6th ed. 1990).

Moreover, MindGames neglects persuasive case law in this area. Generally, the courts have treated lost royalties in the same manner as lost profits in damages claims. See Oral-X Corp. v. Farnam Companies, Inc., 931 F.2d 667, 670 (10th Cir. 1991) (reversing district court's refusal to award damages for royalties as lost profits); In re Mid-America Corp., 159 B.R. 48, 55 (M.D. Fla. 1993) (the speculative nature of determining lost profits precluded franchisor's recovery of damages for lost royalties).

In sum, the Court sees the difference between profits and royalties as a *de minimis* one. The important issue is that MindGames seeks the recovery of a form of compensation; for these purposes, no difference exists between royalties and profits.

D. Whether Granting Partial Summary Judgment to Western is Appropriate.

Whether the court decides to grant summary judgment on this matter depends on whether any genuine issue of material fact related to the controlling, substantive law of the case remains to be disputed at trial. Kendrick v. East Delavan Baptist Church, 886 F. Supp. 1465 (E.D. Wis. 1994) (Warren, J.). If the court determines that either the movant established uncontroverted facts entitling it to summary judgment or demonstrated that the non-moving party has failed to make a sufficient showing on an essential element of the

case, then a grant of summary judgment is proper. Donovan v. City of Milwaukee, 845 F. Supp. 1312 (E.D. Wis. 1992) (Reynolds, J.), *aff'd,* 17 F.3d 944 (7th Cir. 1994).

Because the Court accepts current Arkansas law as controlling, no issue of material fact regarding lost anticipated profits remains. In addition, the Court finds that MindGames has failed to meet its obligation to make a sufficient showing on any essential element relating to the attempt to seek lost profits. The law of Marvell Light remains valid, and under Seventh Circuit precedent, the Court must follow it. Therefore, summary judgment as a matter of law is proper in this case.

Furthermore, granting summary judgment on the issue of the "New Business Rule" is not uncommon and lends support to the Court's decision. Although most "New Business Rule" cases arise out of a court of appeals overturning the trial court's award for lost anticipated profits, occasionally the matter is dismissed at summary judgment. In Rich v. Eastman Kodak, 583 F.2d 435, 437 (8th Cir. 1978), the Eighth Circuit upheld the Eastern District of Missouri's grant of summary judgment in a case where lost profits could not be claimed because the party seeking the recovery had no history of profitability by which to measure anticipated profits. The Eighth Circuit also upheld the Southern District of Iowa's grant of summary judgment in United States v. Dura-Lux International Corp., 529 F.2d 659 (8th Cir. 1976). In Dura-Lux, the defendant counterclaimed against the United States for lost profits. The court granted the United States' motion for summary judgment on the basis that the profits were unduly speculative since the business was "an untried

enterprise with no history of profitability." Dura-Lux, 529 F.2d at 663.

Finally, a summary judgment dismissal of a claim for anticipated profits is not unheard of within this jurisdiction. In Autotrol Corp. v. Continental Water Sys. Corp., 694 F. Supp. 603 (E.D. Wis. 1988) (Gordon, J.), a case strikingly similar to the case at hand, Judge Gordon granted summary judgment in a case applying Texas law. Texas law strictly embraces the "New Business Rule" (See Atomic Fuel Extraction, *supra),* and Judge Gordon agreed with the defendants' claim in Autotrol that the plaintiff could not recover profits as a matter of law. Autotrol, 694 F. Supp. at 605. Because Arkansas strictly follows the "New Business Rule," no reason exists why the Court cannot follow the precedent of this District and grant summary judgment in favor of Western.

IV. CONCLUSION

Based on the foregoing discussion, the Court holds that the application of Arkansas law to the undisputed facts of this case establishes that MindGames cannot, as a matter of law, recover its lost profits from anticipated sales of *Clever Endeavor.*

THEREFORE, IT IS HEREBY ORDERED:

1 . Western Publishing Company, Inc.'s Motion for Partial Summary Judgment is GRANTED.

2. Western Publishing Company, Inc.'s Motion to Strike is DENIED.

3. The Court has scheduled a conference call for 9:30 a.m., Monday, October 28, 1996 to address further scheduling of this case. Counsel for Western Publishing Company, Inc. is to initiate the call.

SO ORDERED this 11th day of October, 1996, at Milwaukee, Wisconsin.

Robert W. Warren
United States District Judge

In the

United States Court of Appeals

For the Seventh Circuit

August 22, 2000

Before

Hon. Thomas E. Fairchild, *Circuit Judge*
Hon. Richard A. Posner, *Circuit Judge*
Hon. Diane P. Wood, *Circuit Judge*

No. 98-1879

MINDGAMES, INC.

Plaintiff-Appellant,

v.

WESTERN PUBLISHING COMPANY, INC.,

Defendant-Appellee.

Appeal from the United States District Court
for the Eastern District of Wisconsin.
Nos. 94 C 552, 94 C 998 -- **Lynn S. Adelman**, *Judge*

ORDER

On July 6, 2000, plaintiff-appellant filed a petition for rehearing and petition for rehearing *en banc* and on August 8, 2000 defendant-appellee filed an answer with appendix. A majority of the judges on the original panel have voted to deny the petition. None of the active judges has requested a vote on the petition for rehearing *en banc*. The petition is therefore DENIED.

Hon. Thomas E. Fairchild voted to grant the petition for rehearing

United States District Court

Eastern District of Wisconsin

JUDGMENT IN A CIVIL CASE

WESTERN PUBLISHING COMPANY, INC.

Plaintiff,

vs. Case Number: 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

vs. Case Number: 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

Decision by the Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that all claims of the plaintiff, MindGames, Inc., in Case No. 94-C-998 other than those dismissed pursuant to the summary judgment decisions and orders entered herein on October 11, 1996 and February 25, 1998 are hereby dismissed without prejudice and without costs.

March 20, 1998

SOFRON B. NEDILSKY
Clerk

United States District Court

Eastern District of Wisconsin

WESTERN PUBLISHING COMPANY, INC.

Plaintiff,

vs. Case Number: 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

vs. Case Number: 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

WESTERN PUBLISHING COMPANY, INC.'S MEMORANDUM IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT

I. INTRODUCTION

The driving force behind this dispute between MindGames, Inc. ("MindGames") and Western Publishing

Company, Inc. ("Western") is MindGames' belief that Western's alleged breach of the parties' license agreement prevented MindGames' new adult board game called *"Clever Endeavor"* from achieving the same success as two of the most successful adult board games of all time, *Pictionary* and *Trivial Pursuit*. Rather than attributing *Clever Endeavor's* limited success to the erratic whims of the consumer and the game's own shortcomings, MindGames is determined to place the blame on Western -- the exclusive licensee of *Clever Endeavor* for almost its entire shelf life. In so doing, MindGames seeks over $40 million dollars in damages for profits it allegedly lost due to Western's breach of the license agreement. However, MindGames cannot, as a matter of law, recover its alleged lost profits because Arkansas still applies the "New Business Rule," which *prevents* the recovery of *any* lost profits for a new product, such as *Clever Endeavor*. The inherent difficulties of predicting the success of a product in the entertainment and leisure industry further dictate the strict application of the New Business Rule.

Moreover, MindGames' failure to show any history of profitability before its license agreement with Western, provides a second reason that MindGames is legally precluded from recovering any anticipated lost profits. Consequently, Western respectfully requests that this Court grant it partial summary judgment on the portion of MindGames' claim which seeks damages for its alleged lost profits.

II. WESTERN'S PROPOSED FINDINGS OF FACT

A. The Parties.

1. Western Publishing Company, Inc. ("Western") is a corporation organized and existing under the laws of the State of Wisconsin, with its principal place of business located at 1220 Mound Avenue, Racine, Wisconsin.

2. MindGames, Inc. ("MindGames") is a corporation organized and existing under the laws of the State of Arkansas, with its principal place of business located at 2720 West 28th Street, Pine Bluff, Arkansas.

B. Jurisdiction and Venue.

3. Western and MindGames are citizens of different states and the matter in controversy involves a sum in excess of $50,000, exclusive of interest and costs. Accordingly, this Court has jurisdiction over this action pursuant to 28 U.S.C. §1332(a).

4. Western has its principal place of business in the Eastern District of Wisconsin, and the causes of action asserted in this lawsuit arose in this District. Venue is therefore proper in this District pursuant to 28 U.S.C. §1391(a).

C. The Development of *Clever Endeavor*.

5. In March 1988, Larry Blackwell ("Blackwell") formed MindGames for the sole purpose of manufacturing, marketing and selling a new adult board game he invented called *Clever Endeavor*. (See p. 24 of the

Deposition of Larry Blackwell ("Blackwell Dep."). Copies of the relevant pages of Mr. Blackwell's deposition transcript are attached hereto as Group Exhibit A). *Clever Endeavor* was MindGames' first and only product. (Blackwell Dep. p. 34).

6. At the time Blackwell formed MindGames, he had no prior experience in the game industry or the adult game market in particular. (Blackwell Dep. pp. 46, 84). Nevertheless, Blackwell believed that *Clever Endeavor* would appeal to the same market and achieve the same success as the two most successful adult board games of their time, *Pictionary* and *Trivial Pursuit*. (Blackwell Dep. pp. 79-81). Blackwell formed this belief without having any discussions with anyone in the game industry regarding what features made *Trivial Pursuit* and *Pictionary* successful games. (Blackwell Dep. p. 82).

7. Prior to its initial distribution of the game in September 1989, MindGames conducted some minimal test marketing of *Clever Endeavor,* such as playing the prototype of *Clever Endeavor* with focus play groups out of Blackwell's parents' and friends' homes. (Blackwell Dep. pp. 160-165).

8. In the spring of 1989, Blackwell decided to publish *Clever Endeavor*. (Blackwell Dep. p. 107). From the spring of 1989 through the end of the year, MindGames marketed the game itself by promoting it at certain events and through radio advertising and cooperative advertising with retailers. (Blackwell Dep. p. 172). MindGames, however, did not use any type of television advertising to

promote *Clever Endeavor* because Blackwell did not believe that the cost for such advertising justified the expense. (Blackwell Dep. pp. 174-175).

9. During 1989, MindGames sold approximately 30,000 games, but failed to achieve a profit for that year. Blackwell Dep. pp. 169; See, the 1989 Income Statement for MindGames, a copy of which is attached hereto as Exhibit B).

D. The License Agreement.

10. In December 1989, Blackwell met with two representatives from a game company called Games Gang, Inc. ("Games Gang"), which was the current distributor of *Pictionary*. (Blackwell Dep. pp. 192-193). These discussions culminated on March 30, 1990 when MindGames, as Licensor, entered into an exclusive license agreement with Western and Games Gang, as Licensees, for the manufacture, marketing, promotion, sale and distribution of the *Clever Endeavor* game (the "License"). (A copy of the License is attached hereto as Exhibit C).

11. The License is governed in all respects by the laws of the State of Arkansas. (Exhibit C at ¶ 20).

12. The License, among other things, required Western and Games Gang to pay MindGames royalties based on the number of games sold and to provide a minimum amount of advertising support to *Clever Endeavor*. (Exhibit C at ¶¶ 4, 6).

13. The term of the original License extended through January 31, 1993. (Exhibit C at ¶ 2). The License

provided that, if the Licensees were not in breach, the License would continue until January 31, 1994 in the event that the Licensees paid MindGames at $1.5 million (whether earned or unearned in royalties during the term of the License) prior to January 31, 1993. (Exhibit C at ¶ 2). For any renewal term beginning on or after January 31, 1994, the Licensees were required to pay MindGames $300,000, less royalties earned between January 31, 1993 and January 31, 1994. (Exhibit C at ¶ 2).

14. On March 13, 1991, the parties amended the License by allowing the Licensees to reduce the percentage of gross sales to be utilized for advertising and promotion in order to "keep the cost of the game down." A copy of the March 13, 1991 letter agreement amending the License (the "1991 Amendment") is attached hereto as Exhibit D.

15. With the written consent of MindGames, Western assumed the duties and obligations of the other licensee, Games Gang, under the License, pursuant to a sublicense agreement dated February 3, 1992. Western served as the exclusive licensee of *Clever Endeavor* through January 31, 1994.

16. The net sales of *Clever Endeavor* during the original term of the License were as follows:

Fiscal Year	*Clever Endeavor* Units Sold
FY 1990	165,000
FY 1991	58,113
FY 1992	26,394
FY 1993	7,438

III. NATURE OF THE DISPUTE

MindGames alleges that *Clever Endeavor* was not successful because Western breached the License by, inter alia, 1) failing to pay MindGames the minimum royalties necessary to renew the License, 2) failing to properly manufacture and distribute *Clever Endeavor,* 3) failing to "diligently and actively promote and make every reasonable effort to market and sell *Clever Endeavor*" and 4) failing to provide the amount of advertising support required under the License. (See, MindGames' Complaint, a copy of which is attached hereto as Exhibit E). As a result of the alleged breach of the License by Western, MindGames seeks damages against Western in excess of $40 million dollars. (See the April 25, 1995 letter from MindGames' attorney, a copy of which is attached hereto as Exhibit F). MindGames bases almost the entire amount of its damage claim on the profits it allegedly lost due to Western's alleged breach of the License.[1]

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[1]MindGames also seeks $1.2 million for royalties allegedly owed to renew the License for the period of February 1, 1993 through January 31,

(continued...)

IV. ARGUMENT

A. The Standard For Granting Summary Judgment.

Rule 56(c) of the Federal Rules of Civil Procedure deems summary judgment appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Kendrick v. East Delavan Baptist Church, 886 F. Supp. 1465, 1471 (E.D. Wisc. 1995) (Warren, J.) citing Celotex Corp. v. Catrett, 477 U.S. 317, 322, 106.S. Ct. 2505, 2510 (1986); see, Donovan v. City of Milwaukee, 845 F. Supp. 1312, 1313 (E.D. Wisc. 1992) (Reynolds, J.). The presence of a genuine issue of material fact is to be determined by the substantive law controlling that case or issue. Kendrick, 886 F. Supp. at 1471. Although some facts may be in dispute, entry of summary judgment is in order if the movant either establishes uncontroverted facts entitling it to summary judgment or demonstrates that the non-moving party has failed to make a sufficient showing on an essential element of its case with respect to which it will bear the burden of proof at trial. Donovan, 845 F. Supp. at 1314.

The application of Arkansas law to the undisputed facts of this case establishes that MindGames cannot, as a matter of law, recover its lost profits. Therefore, Western

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[1](...continued)
1994 and for the period of February 1, 1994 through January 31, 1995.

respectfully requests that this Court grant it partial summary judgment, and find that MindGames is precluded from seeking damages for its alleged lost profits.

B. The "New Business Rule" Prevents MindGames From Recovering Any Lost Profits.

Western emphatically denies that it breached any of the terms of the License. However, even assuming *arguendo* that MindGames could demonstrate that Western or Games Gang breached any provision of the License, MindGames is legally precluded from recovering its lost profits.

1. *Arkansas follows the "New Business Rule."*

As a new business, MindGames is barred under Arkansas law from introducing any evidence regarding its lost profits. Arkansas follows the "New Business Rule," which holds that a new or unestablished business is precluded, as a matter of law, from recovering lost profits. Marvell Light & Ice Co. v. General Electric Co., 162 Ark. 467, 259 S.W. 741 (1924). The Arkansas Supreme Court reasoned that '[t]he anticipated profits of a new business are too remote, speculative and uncertain to support a judgment for their loss." 259 S.W. at 741. Accord Central Coal & Coke Co. v. Hartman. I 1 1 F. 96, 98 (8th Cir. 1901).

Although the Supreme Court of Arkansas has not addressed this issue since it decided Marvell Light in 1924, there is no reason to believe that the Arkansas Supreme Court's has changed its position on the recovery of lost profits by a new business. Despite exhaustive research,

Western has failed to discover a single Arkansas case considering evidence of lost products for a new business after the Marvell Light decision This dearth of authority supports the proposition that Arkansas courts continue to adhere firmly to Marvell Light.

Nor is there any reason to believe that the Arkansas courts would deviate from the Marvel Light decision now. The rationale supporting the Arkansas Supreme Court's ruling continues to remain as persuasive today as it did in 1924. As the Fourth Circuit explained in Coastland Corp, v. Third National Mortgage, Co., 611 F.2d 969 (4th Cir. 1979), the New Business Rule provides a "safeguard" against an unsubstantiated award of damages for lost profits:

> "If an established business, with an established earning capacity, is interrupted and there is no other practical way to estimate the damages thereby caused, evidence of the prior and subsequent record of the business is admissible to permit an intelligent and probable estimate of damages... But where a ***new*** business or enterprise is involved, the rule is not applicable for the reason that such a business is a ***speculative venture,*** the successful operating of which depends upon future bargains, the status of the market, and too many other contingencies to furnish a safeguard in fixing the measure of damages."

(Emphasis added). Coastland Corp., 611 F.2d at 977. In fact, the New Business Rule actually serves to encourage new businesses. Fear of exposure to a damages claim arising from an inventor's own expectation of his product's potential for success would chill companies like Western from seeking to promote new products.

It is therefore not surprising that a number of courts have recently affirmed the New Business Rule, and refused to consider evidence of lost profits for a new business. See, e.g. Stuart Park Associates Limited Partnership v. Ameritech Pension Trust, 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law); Hillside Enterprises v. Carlisle Corp., 69 F.3d 1410, 1413-1415 (8th Cir. 1995) (Oklahoma law); Springwill Dispensers, Inc. v. Hall China Company, 204 Ga. App. 245, 419 S.E.2d 112 (1992) (Georgia law); Center Ridge Ganley, Inc. v. Stinn, 71 Ohio App. 3d 514,594 N.E.2d 1064, 1070 (1991) (Ohio law); International Minerals and Resources, Inc. v. Pappas, 761 F. Supp. 1069, 1079 (S.D.N.Y. 1991) (New York law); Murray, etc., et al. v. Hadid, et al., 238 Va. 722, 385 S.E.2d 898, 905 (1989) (Virginia Law); In re Phoenix Restoration Specialists, Inc., 14 B.R. 115, 123-24 (Bkrptcy. Mass. 1981) (Massachusetts law).

2. Clever Endeavor was a new venture or a new business.

Although MindGames incorporated in March 1988, MindGames was clearly a new business in March of 1990 when it executed the License and joined forces with Western and Games Gang. Consequently, MindGames, as

a "new business," is subject to the repercussions of the New Business Rule.

Blackwell asserts that he envisioned *Clever Endeavor* when he incorporated MindGames in March 1988; however, MindGames did not decide to even market *Clever Endeavor* until the spring of 1989, and it did not manufacture and distribute the first wave of *Clever Endeavor* games until September 1989. (See Blackwell Dep. pp. 24, 107, 168-169). Four months after MindGames began to distribute *Clever Endeavor,* Blackwell met with representatives of Games Gang to discuss a joint venture. (See, Blackwell Dep. pp. 192-193). These discussions culminated in the execution of the License in March 1990. In total, MindGames marketed and sold *Clever Endeavor* itself for less than a year before it joined forces with Western and Games Gang, and it failed to achieve ***any*** profit during that period of time. (See Exhibit B; see also MindGames' 1988 income statement, a copy of which is attached hereto as Exhibit G).

Under these circumstances, MindGames is clearly a "new" business as a matter of law. See, e.g. McBrayer v. Teckla, Inc., 496 F.2d 122 (5th Cir. 1974) (plaintiff not entitled to lost profits in his breach of contract claim because he was only in operation for 9 and a half months prior to the contract and failed to achieve a profit during that time); Delhanty, et al. v. First Pennsylvania Bank, N.A., 318 Pa. Super. 90, 464 A.2d 1243 (1983) (court held that plaintiff company's anticipated profits were too speculative to sustain an award of damages because plaintiff

had only been in operation for seven months and had no record of profitability).

MindGames may argue that it was an "established" business at the time it executed the License, and, therefore, it is not subject to the New Business Rule. However, such an assertion would be in vain.

MindGames had barely introduced *Clever Endeavor* to the public before it executed the License and permitted Western and Games Gang to exclusively manufacture, market, sell and distribute *Clever Endeavor*. Moreover, MindGames operated ***only*** at a loss prior to joining forces with Western and Games Gang. .(See, Exhibits B and G). These traits are not characteristic of an "established" business.

> "An established business should be one that is in actual operation long enough to give it permanency and recognition. It should be one that has earned a profit which can reasonably be ascertained and approximated ... Proof of an operation of a business at a loss fails to meet this test."

McBrayer, 496 F.2d at 128, quoting Atomic Fuel Extraction Corporation v. Slick, 386 S.W.2d 180, 189 (Tex. Ct. Civ. App. 1964).

Additionally, Blackwell's own admissions contradict any claim that MindGames, whose sole product was *Clever Endeavor*, was not a "new" business. In his September 12, 1990 letter to Games Gang, Blackwell relayed his concerns about the proposed television advertising campaign for

Clever Endeavor. Significantly, one of the reasons he rejected the proposed commercial had to do with his classification of *Clever Endeavor* as a new product:

> "Furthermore, ***new*** products don't benefit from short duration commercials in the same way as older, more established products do. ***New*** products need longer duration commercials in order to gain the same consumer response."

(Emphasis added) (A copy of Blackwell's September 12, 1990 letter to Games Gang is attached hereto as Exhibit H). Clearly, Blackwell himself still considered *Clever Endeavor* to be a new product six months ***after*** the parties executed the License. Consequently, MindGames will not be able to avoid the New Business Rule's preclusive effect on its attempt to recover its alleged lost profits.

3. The success of a new product in the entertainment industry is especially difficult to predict.

Even if the Court were to question whether the Arkansas Supreme Court would retreat from its across the board application of the New Business Rule, there can be no doubt that such a retreat would not be warranted here. It is particularly appropriate to apply this rule in the entertainment/consumer product industry where the chances of success are next to impossible to predict because an entertainment product, such as an adult board game, is subject to the most subjective and unpredictable critic - the public. See, Proteus Books Ltd. v. Cherry Lane Music Co,

873 F.2d 502, 510 (2nd Cir. 1989) (affirming district court's decision to vacate jury's damages award because, inter alia, inherent uncertainties of predicting profits in the entertainment industry made prospective sales of book publisher difficult, if not impossible, to calculate); Kenford Co. v. County of Erie, 67 N.Y.2d 257, 493 N.E.2d 234, 236 (1986) (court found plaintiff's evidence of prospective profits of new stadium insufficient to support any recovery for lost profits).

Among numerous other factors, the success of a product in the entertainment industry is contingent on many subjective factors including:

- the play value or enjoyment one obtains from the product;
- the economy at the time the product is introduced to the market;
- the number of similar products in the market;
- the cost of the product itself.

Mr. Blackwell himself has conceded that the game industry is especially susceptible to the unique tastes of the average consumer and unanticipated oscillations in the marketplace. In his October 18, 1990 letter to Greta Perry of the Gazette Newspapers in New York, Blackwell attached Ms. Perry's recent article on the game industry and praised Ms. Perry's "keen analysis" of what makes a game successful. (A copy of Blackwell's October 18, 1990 letter and the attached article by Ms. Perry is attached hereto as Exhibit I). In Ms. Perry's article, one industry

commentator noted: "For every 1000 games that get invented, five make it to the shelf and maybe one of two get a ***second*** year." (Emphasis added) (See, Exhibit I). Later, in his application to Harvard Business School in 1994, Blackwell himself acknowledged the difficulty of marketing a successful game in the entertainment industry when he admitted that:

> "[building a successful game company and licensing their first product] is a popular and powerful dream, but unfortunately, too few actually succeed. When one recalls the more publicized failures of product introductions by established corporations, I [Blackwell] believe [MindGames'] accomplishment becomes more substantial. The experience proved my [Blackwell's] business and leadership skills in a hostile and unforgiving market." (See, p. 7 of Mr. Blackwell's application to Harvard Business School, a copy of which is attached hereto as Exhibit J.)

Despite these long odds, Blackwell thought that *Clever Endeavor* would be the "next *Trivial Pursuit* or *Pictionary*, (See, Exhibit F), and he was apparently disappointed that *Clever Endeavor* fell short of his lofty expectations.[2] However, *Clever Endeavor's* limited success

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[2]Mr. Blackwell's credibility on the issue of *Clever Endeavor's*

(continued...)

can be attributed to many factors independent of the alleged manufacturing or advertising problems, including the following potential causes:

1. *Clever Endeavor* was one of the more expensive adult games in the market (Blackwell Dep. p. 98);

2. There were other similar adult board games on the market, including *Anybody's Guess,* which were similar to *Clever Endeavor* (Blackwell Dep. pp. 423-433);

3. Despite Western's advice, Blackwell rejected television advertising in favor of radio advertising (Blackwell Dep.

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[2](...continued)
purported lack of success is questionable at best. Contrary to the allegations in MindGames' complaint, Mr. Blackwell repeatedly touted the "success" of Clever Endeavor. For example, in his applications to Harvard and Stanford business schools, Blackwell claims that *Clever Endeavor* was the "most successful, independently published game in the [adult game] industry for the four years following its introduction" and the "most successful game introduced by an independent game publisher in the past five years." (See, Exhibit J at p. 7; see also Mr. Blackwell's application to Stanford Business School, a copy of which is attached hereto as Exhibit K, and Mr. Blackwell's June 6, 1994 letter to the Harvard Business School, a copy of which is attached hereto as Exhibit L.) Moreover, in his September 7, 1990 letter to Games Gang, Blackwell states: "Thanks for your terrific support. You're the reason for Clever Endeavor's **success**. (Emphasis added) (A copy of the September 7, 1990 letter is attached hereto as Exhibit M.)

pp. 361, 369-370, 378, 386-392; see also Blackwell's September 12, 1990 letter to Dave Gillies at Games Gang regarding the effectiveness of radio advertising, a copy of which was previously attached hereto as Exhibit H);

4. *Clever Endeavor's* first full year in the marketplace, 1990, was a "rotten" year for the industry as a whole (See, Blackwell's January 9, 1991 letter to Mary Mellor at Games Gang, a copy of which is attached hereto as Exhibit N); and

5. The play value of the game itself, which may not have appealed to consumers to the degree Mr. Blackwell hoped.

The aforementioned facts are just a few of the many reasons that *Clever Endeavor* did not become the next *Trivial Pursuit* or *Pictionary*. It is the nature of the entertainment industry itself, as well as common sense, which necessarily dictate that one cannot point to a single factor which caused *Clever Endeavor* to fail to achieve the success MindGames now claims it expected.

The Eight Circuit Court's opinion in Hillside Enterprises illustrates the rationale and application of the New Business Rule in the entertainment/consumer product industry. In Hillside Enterprises, a wine marketer

("Hillside") sued a disposable wine manufacturer ("Carlisle") for breach of contract after the manufacturer failed to properly manufacture and ship the required number of Hillside's new product -- disposable plastic wine glasses with fliptop lids. Hillside alleged that it could not fill its first, and only, large order for 30,000 glasses, and that its "wine-in-a-glass" venture lost substantial profits and ceased operations as a result of Carlisle's failure to adequately manufacture the new product.

At trial, Hillside attempted to introduce evidence of its future sales from wine glasses which had not yet been ordered. The district court, however, refused to admit this evidence because it was too speculative, and Hillside appealed. On appeal, the Eight Circuit Court affirmed the district court's ruling, and expressly noted that lost profits are highly speculative and are generally not allowed as damages where a new business or product are at issue. Hillside Enterprises, 69 F.3d at 1414. Moreover, the court found that Hillside's product could have failed for reasons independent of the problems with the glasses, such as the cost of the product or consumers' failure to find the convenience of packaged wine more important than the price and quality of the wine. Id. For these reasons, the appellate court upheld the district court's decision to *only* allow evidence of lost profits from Hillside's one confirmed order for 30,000 glasses, which Hillside was unable to fulfill because of Carlisle's breach. Id.

Unlike the plaintiff in Hillside Enterprises, MindGames does not even allege that it lost profits as a result of Western's failure to fulfill a specific sales order or

that Western otherwise failed to pay MindGames its royalties for *Clever Endeavor* games previously sold by Western. Rather, MindGames only seeks profits from the uncertain or future sales of *Clever Endeavor* which it allegedly lost due to Western's breach of the License. Without being able to determine the "cause," MindGames cannot possibly be able to demonstrate the "effect" (*i.e.*, lost profits) with any reasonable certainty. Consequently, this Court should strictly apply the New Business Rule, as the Supreme Court of Arkansas did in Marvell Light & Ice Co., and prohibit MindGames' recovery of all its alleged lost profits as a matter of law.[3]

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[3]As a result of the unpredictable nature of the entertainment industry, it is not surprising that other parties similarly situated to MindGames have also been unable to recover the alleged lost profits of their new businesses. See, *e.g.*, Proteus Books Ltd. v. Cherry Lane Music Co., supra; National Controls v. National Semiconductor, 833 F. 2d 491 (3rd Cir. 1987) (buyer of microprocessor units failed to sustain burden of proving under Pennsylvania law that seller's breaches were proximate cause of buyer's alleged loss of profits on sale of telephones to third party, and, therefore, buyer not entitled to damages for lost profits); Handi Caddy, Inc. v. American Home Products Corp., 557 F.2d 136 (8th Cir. 1977) (8th Circuit Court reduced jury's damages award for lost profits because evidence in action to recover for breach of contract to advertise new product on pizza packages failed to support recovery of lost profits awarded by jury.); Murray, etc. et. al v. Hadid, et. al., supra (affirming trial court's decision to set aside jury's award of lost profits because evidence of new enterprise's lost profits depended upon too many contingencies to safeguard an estimate of damages); Kenford Co., Inc. v. County of Erie, supra.

4. MindGames has no history of past profits.

Even if the Court were to reject a strict application of the New Business Rule, this Court should still grant Western's motion for partial summary judgment because MindGames has no history of past profits.

In addition to the inherent difficulties of predicting the success of a new entertainment product, MindGames faces the additional burden of demonstrating its alleged lost profits without any prior history of profitability. It is undisputed that MindGames will not be able to introduce evidence of its profits prior to the alleged breach of the License committed by Western because MindGames failed to achieve any profit in 1988 or 1989. (See, Exhibits B and G). Without any evidence of past profits, anticipated profits often cannot be recovered regardless of whether the damaged party was a new business. See, Rich v. Eastman Kodak Company, 583 F.2d 435, 437 (8th Cir. 1978) (plaintiff company unable to recover its anticipated profits because it was not making a profit before problems developed with the product); Empire Shoe Company v. Nico Industries, Inc., 197 Ga. App. 411, 414, 398 S.E.2d 440, 443 (1990) (granting defendant summary judgment on the issue of lost profits because plaintiff could not produce any evidence regarding past net profits); see also Keener v. Sizzler Family Steak Houses, 597 F.2d 453, 459 (5th Cir. 1979). Consequently, without such evidence of past profits, MindGames will lack a reliable basis to demonstrate its alleged lost profits with any reasonable certainty.

V. CONCLUSION

For all the aforementioned reasons, Western respectfully requests that this Court grant its motion for partial summary judgment and find that MindGames cannot recover its alleged lost profits as a matter of law.

Dated: May 17, 1996

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United States District Court
Eastern District of Wisconsin

WESTERN PUBLISHING COMPANY, INC.

Plaintiff,

vs. Case Number: 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

vs. Case Number: 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

WESTERN PUBLISHING COMPANY, INC.'S REPLY BRIEF IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT

Dated: August 8, 1996

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INTRODUCTION

The response of MindGames, Inc. ("MindGames") to the motion for partial summary judgment filed by Western Publishing Company, Inc. ("Western")[1], is legally

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[1]Subsequent to the filing of this Motion for Partial Summary Judgment

(continued...)

and factually deficient MindGames fails to invoke a single case decided under Arkansas law which even criticizes -- much less rejects or overrules -- *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924). Unable to argue that Arkansas law no longer employs the New Business Rule, MindGames is left to contend that this Court should modify Arkansas law by refusing to follow the *Marvell Light* decision. Instead, MindGames asks this Court to follow the trend in certain other jurisdictions to allow a new business to introduce evidence of its alleged lost profits. This argument contravenes the Seventh Circuit requirement that federal courts in diversity cases follow state law as it currently exists, rather than modifying state law, or predicting a change.

Implicitly recognizing the weakness of its argument, MindGames claims that even if the Court finds that the New Business Rule is viable, the Rule does not apply here because the licensors are not a new business. However, MindGames -- the party seeking lost profits -- is a new business, a fact that MindGames only halfheartedly challenges. Equally untenable is MindGames' contention that the New Business Rule does not apply because MindGames seeks lost "royalties," not lost "profits." The

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[1](...continued)
Western's corporate name has changed from Western Publishing Company, Inc. to Golden Books Publishing Company, Inc. However, to avoid unnecessary confusion, Plaintiff will continue to refer to itself as Western for purposes of this motion.

case law unequivocally establishes that lost royalties are a form of lost profits.

MindGames' response is equally deficient in its failure to meet its burden to come forward with affirmative evidence to rebut the facts Western offers in support of its motion. Even if this Court were to consider the conclusory and self-serving affidavit submitted by G. Lawrence Blackwell III (MindGames' principal), there are no disputed issues of material fact. The evidence Western submitted remains unrebutted. Controlling Arkansas law squarely supports Western's motion. Therefore, this Court should grant Western's motion for partial summary judgment and bar MindGames from seeking to recover any lost profits.

ARGUMENT

A. MindGames Has Failed To Meet Its Burden To Oppose Western's Motion.

At the outset, it is important to note one of the overriding defects in MindGames' response – its failure to meet its burden to come forward with affirmative evidence to counter Western's motion. This Court has repeatedly explained the burden of proof imposed on a party opposing summary judgment:

> The moving party has the initial burden of demonstrating that it is entitled to summary judgment as a matter of law. *[Citations omitted)*. Once this burden is met, the non-moving party must "go beyond the pleadings" and designate specific facts to support or defend each element of the cause

> of action, showing that there is a genuine issue for trial. *[Citations omitted].* Neither party may rest on mere allegations or denials in the pleadings, *[citations omitted,* and both parties must produce proper documentary evidence to support their contention. *[Citations omitted].*

Lisbon Square v. United States, 856 F. Supp. 482, 488 (E.D. Wis. 1994); *accord Criticare Systems, Inc. v. Nellcor Inc.,* 856 F. Supp. 495, 503 (E.D. Wis. 1994); *Flavel v. Svedala Industries, Inc., 868* F. Supp. 1422, 1456 (E.D. Wis. 1994).

Despite these admonitions, MindGames fails to submit any documentary evidence to support its contentions. Instead, MindGames relies solely on the conclusory statements in the Affidavit of G. Lawrence Blackwell III (the "Blackwell Affidavit").[2] This is clearly insufficient. "Self-serving affidavits without factual support will not defeat a motion for summary judgment *[citation omitted].* [A] plaintiff's speculation is not a sufficient defense to a summary judgment motion." *Slowiak v. Land O'Lakes, Inc.,* 987 F.2d 1293 (7th Cir. 1993) (affirming summary judgment dismissing the plaintiff's antitrust claim because the record showed that the plaintiff failed to show injury required for standing.)

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[2]Simultaneously herewith, Western has filed a motion to strike the Blackwell Affidavit

B. MindGames Cannot Refute That *Marvell Light* Is The Controlling Precedent Under Arkansas Law.

The Arkansas supreme court decision in *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924), supplies the legal basis for Western's motion for partial summary judgment to preclude MindGames from introducing evidence of lost profits. As Western explained in its opening brief, *Marvell Light* established Arkansas as a jurisdiction that followed the New Business Rule.

MindGames' response tacitly concedes that *Marvell Light* remains the controlling authority under Arkansas law. MindGames fails to cite a single decision under Arkansas law that criticizes or overrules the *Marvell Light* opinion. Instead, MindGames argues that this Court should decline to follow *Marvell Light* because, at age 72, the decision is "procrustean," "outdated" and no longer followed in a majority of jurisdictions, making it unlikely that an Arkansas court would apply the New Business Rule today. (MindGames' Br. at 13.) This argument is not only unfounded, it is contrary to the well established rules of construction that courts are required to follow in diversity cases such as this.[3]

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[3]Not only does MindGames implicitly disparage all older decisions, it suggests that, contrary to *stare decisis*, courts revisit rules based on older case law.

1. No Arkansas decision represents a departure from *Marvell Light*.

It is curious that Dunn is one of the primary authorities upon which MindGames relies for the proposition that it is unlikely that an Arkansas court today would follow *Marvell Light* (MindGames' Br. at 8, 10.) Dunn expressly includes Arkansas as one of the "diminishing number of states that still follow the new-business rule." 1 Dunn, *Recovery of Damages for Lost Profits* (4th Ed.) Section 4.1 (1992) at 277-78. Dunn makes no suggestion that Arkansas will deviate from *Marvell Light* and reject the New Business Rule. *Id.*

Nevertheless, MindGames contends that because more recent Arkansas decisions suggest a more liberal standard for proof of damages, these cases portend a rejection of *Marvell Light*. (MindGames' Br. at 12.) None of the cases MindGames cites support this proposition. For example, MindGames concedes that *555 Incorporated v. Leming*, 45 S.W.2d 18 (Ark. 1932), did not involve a new business. (MindGames' Br. at 12.)[4] That case stands only for the black letter proposition that lost profits must be proved with reasonable certainty.

Similarly, each of the other Arkansas cases upon which MindGames relies involved an established business rather than a new business. In *Jim Halsey Co., Inc. v.*

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[4]Once again, it is curious that MindGames characters the 1924 *Marvell Light* decision as "procrustean" and outdated, but relies upon *555 Incorporated*, decided only eight years later.

Bonar, 683 S.W.2d 898 (Ark. 1985), the court confronted the issue of whether the plaintiff submitted adequate proof of the amount of lost profits, not whether lost profits were legally available. The plaintiff was established in his field, not in a new business. Therefore, the case cannot be read as a departure from *Marvell Light.* Similarly, both *Tremco, Inv. v. Valley Aluminum Products Corp.,* 831 S.W.2d 156 (Ark. App. 1992), and *Union National Bank of Little Rock v. Mosbacher,* 933 F.2d 1440 (8th Cir. 1991), considered whether an established business -- not a new business -- was entitled to recover lost profits.

MindGames also suggests that *First Service Corp. v. Schumacher,* 702 S.W.2d 412 (Ark. 1985), represents a departure from, the New Business Rule. This is a mischaracterization of the decision. The issue posed in *Schumacher* was whether plaintiff submitted sufficient evidence so that lost profits could be proved with reasonable certainty. The plaintiff was an established developer of residential subdivisions, not a new business. The contract between the parties specified that it was "to cover all remaining lots" in the subdivision. *Id.* at 414. At the time of the alleged breach, the plaintiff had already sold some of the homes in this development, and there were 134 remaining lots to be sold. Therefore, whether the New Business Rule precluded evidence of lost profits was not at issue. In holding that the plaintiff submitted adequate evidence of lost profits, the court found that the sale of other homes in the development provided a basis on which to calculate the potential profits on the sales of the remaining 134 lots. These facts are very different from the

situation presented here. *Clever Endeavor* is the first and only game MindGames offered. (Blackwell Dep. 34.)[5] Blackwell testified that in his opinion MindGames was "unique" and differentiated from all games on the market (Blackwell Dep. 93, 104.)

> 2. Under the controlling rules of construction, this Court is required to follow Arkansas law in its current state rather than to predict how Arkansas court might decide the issue in the future.

MindGames argues that, even if *Marvell Light* is still good law, this Court should nonetheless decline to follow it and instead follow the "majority" rule of allowing a new business to introduce evidence of lost profits. (MindGames' Br. at 10-11.) As both the Seventh Circuit and the Wisconsin District Court have recognized, *Erie R.R. v. Thompkins,* 304 U.S. 64, 58 S. Ct. 817 (1938), prohibits a federal court from modifying state law:

> Under principles of *Erie v. Thompk!ns [citation omitted],* a federal court must apply the state law as declared by the highest state court or otherwise by the intermediate appellate court of the state.

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[5]Relevant excerpts of the Blackwell Deposition are attached hereto as Group Exhibit A.

Kutsugeras v. Avco Corp., 973 F.2d 1341, 1346 (7th Cir. 1992); *accord, Jaeger v. Raymark Industries, Inc.*, 610 F. Supp. 784, 785-6 (E.D. Wisc. 1985) ("Federal courts in diversity actions are bound to accept the interpretations of state law by the state's highest court . . . . The Court's responsibility is to apply the relevant state law as it presently exists."); *Midwest Helicopters Airways v. Sikorsky Aircraft*, 849 F. Supp. 666, 668 (E.D. Wisc. 1994) (same).

These principles apply with even more force here because MindGames elected to file its complaint against Western in federal court under principles of diversity jurisdiction:

> In the context of pendent state law claims, we have already indicated out unwillingness to speculate on any trends in state law. *[Citation omitted.]* This policy applies special force to a plaintiff in a diversity case who has chosen to litigate his state law claim in federal court. We write only to emphasize our policy will continue to be one that requires plaintiffs desirous of succeeding on novel state law claims to present those claims initially in state court.

Shaw v. Republic Drill Corp., 810 F.2d 149,150 (7th Cir. 1987).

This Court has previously rejected a similar request to expand or reconsider state law in a diversity case. In *Afram Export Corp. v. Metallurgiki Halyps, S.A.*, 772 F.2d 1358, 1370 (7th Cir. 1985), the plaintiff sought to recover

as incidental damages interest it had to pay on a business loan. In affirming this Court's dismissal of this damage claim, the Seventh Circuit stated:

> We point out that [plaintiff] chose to bring this lawsuit in federal court (under diversity jurisdiction) rather than in a Wisconsin state court as it could have done. A party who wants a court to adopt an innovative rule of state law should litigate in state court. Federal judges are disinclined to make bold departures in areas of law that we have no responsibility for developing .... But certainly when a resident does invoke the diversity jurisdiction, and perhaps in any case, he cannot expect to receive a very sympathetic hearing for his argument that the federal court should adopt an innovative interpretation of state law.

The issue presented in *Afram* is precisely the issue presented here, and this Court should again refuse the plaintiffs invitation to change state law.

MindGames' reliance on *In re Merritt Logan, Inc.*, 901 F.2d 349 (3rd Cir. 1990), does not change this result. Not only is *Merritt Logan* factually distinguishable, the approach taken by the Third Circuit conflicts with how the Seventh Circuit applies state law in diversity cases. *Merritt Logan* confronted the question of whether a new business could recover lost profits under New Jersey law. The Third Circuit acknowledged that existing New Jersey case law

followed the New Business Rule, and that the New Jersey supreme court had not recently considered the issue. The Third Circuit interpreted its role as to "predict whether the New Jersey Supreme Court would follow the rule against giving a new business damages for lost profits if it were now presented with that issue in the context of this case." 901 F.2d at 357. Of course, this statement is directly contrary to the standard in the Seventh Circuit (See, pp. 5-6, *supra.)*

Moreover, even if the standard in the Seventh Circuit were not inconsistent with that taken *in Merritt Logan, Merritt Logan* would still not support MindGames' argument because there is a significant factual difference between that case and this one. In *Merritt Logan,* the Third Circuit noted that there was a recent decision by the New Jersey District court permitting a new business to recover lost profits. 901 F.2d at 357. There is no such decision by any court applying Arkansas law.

3. It Is Irrelevant That Jurisdictions Other than Arkansas Have Rejected The New Business Rule.

MindGames also argues that this Court should anticipate the Arkansas supreme court's rejection of the New Business Rule because other states have recently reconsidered the issue and abandoned the Rule. Once again, MindGames advances a rule of construction that the Seventh Circuit rejects:

> Given that Florida law governs this case, the authorities form other jurisdictions cited and

> argued by the parties [citations omitted] are only indirectly relevant.

Gust K. Newberg Construction Co. v. E.B. Crump & Co., 818 F.2d 1363, 1368 n .7 (7th Cir. 1987). Therefore, it is irrelevant that Michigan and Ohio may have abandoned the New Business Rule. (MindGames' Br. at 14-15.) Moreover, as Western pointed out in its initial brief, while some courts have rejected the New Business Rule, other jurisdictions have recently reaffirmed their commitment to follow the New Business Rule. (Western Br. at 9.)

C. MindGames Cannot Escape The New Business Rule By Arguing That It Does Not Apply To The Facts Presented Here.

MindGames tries to avoid the application of the New Business Rule by arguing that, even if this Court does follow *Marvell Light*, that case does not apply to the facts presented here. None of the distinctions MindGames tries to draw can save its claim for lost profits.

1. The Sale of Clever Endeavor Under The License Agreement Is A New Business.

First, MindGames contends that the New Business Rule does not apply because "Western and Games Gang are established businesses." (MindGames' Br. at 1-2, 9.) This argument misses the point. The New Business Rule examines whether the entity seeking to recover lost profits is a new business. (*See, e.g., Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410 (8th Cir. 1995) (holding that the plaintiff could not recover lost profits allegedly caused

by the defendant's improper manufacture of its product, which the plaintiff claimed left him unable to fill future orders). Here, it is MindGames -- not Western or Games Gang -- which seeks to recover lost profits. Accordingly, the New Business Rule will apply if MindGames – or a venture comprised of MindGames, Western and Games Gang -- is a new business.

Whether viewed alone or in context with Western and Games Gang, MindGames must be classified as a new business. MindGames cannot and does not seriously challenge Western's claim that it is a new business, contesting neither the legal nor the factual support Western invokes. (See Western Br. at 9-12.) It is not surprising that MindGames chooses to ignore this evidence, since it difficult to imagine how MindGames could counter it. MindGames wisely does not even suggest that the sale of *Clever Endeavor* under the License Agreement is not a new business.

Instead, MindGames argues that *Clever Endeavor* was not a new product "in any relevant sense" because prior to the License Agreement, "it had been on the market for about a year and had enjoyed a high degree of success during the seven months that MindGames was shipping it." (MindGames' Br. at 3.) These statements are inaccurate:

- MindGames sold *Clever Endeavor* from September 1989 until early 1990. (Blackwell Dep. at 170.) This is at most a five month period.

- Prior to MindGames' commencement of sales in September 1989, MindGames projected it would sell 50,000 games in 1989. (Blackwell Dep. at 105.) In fact, MindGames sold only 30,000. (Blackwell Dep. 169.) It is not surprising that both Blackwell and MindGames' marketing manager Leslie Cox May characterized MindGames' sales prior to the License Agreement as only "satisfactory." (Blackwell Dep. 190; May Dep. 43.)[6]

- MindGames failed to earn any profit on *Clever Endeavor* sales prior to the commencement of the License Agreement. (App. Exhs. B and G.)

Even if these statements were true, they are irrelevant. As Western pointed out in its initial brief, courts have found businesses with an operating history of seven months or more to be subject to the New Business Rule. (Western Br. at 10.) MindGames does not address this case law.

2. The New Business Rule Applies To A New Product Sold By An Existing Business.

MindGames argues that, even if *Clever Endeavor* is deemed to be a new product, the New Business Rule still

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[6]The relevant excerpts of the deposition of Leslie Cox May ("May Dep.") are attached hereto as Exhibit B.

does not apply because it is inapplicable to new products sold by an existing business. Even if this Court were persuaded that MindGames had produced evidence that *Clever Endeavor* was sold by an existing business, none of the cases MindGames cites draw a distinction between a new business and a new product sold by an established business. In *John D. Copanos & Sons, Inc.* v. *McDade Rigging and Steel Erection Co.*, 403 A.2d 402 (Md. App. 1979), the court observed that the Maryland supreme court had ***not*** laid down a "flat rule" that a new business cannot recover lost profits. The court found it questionable whether the business at issue (the encapsulating process of penicillin) was even a new business, since the plaintiff had produced penicillin in other forms for years. In contrast here, not only has the Arkansas supreme court laid down a flat rule prohibiting a new business from recovering lost profits, neither MindGames nor Blackwell had any experience in the game industry prior to developing Cleaver Endeaver. (Blackwell Dep. 46.)

MindGames fares no better in relying on *Care Travel Co. v. Pan American World Airways, Inc.*, 944 F.2d 983 (2nd Cir. 1991. There, the plaintiff alleged that the defendant breached the agency agreement by allowing others to sell tickets for the London - Katachi, Pakistan - Bombay route. The court found that the travel agency at issue was not a new venture because (1) the principals had significant prior experience, not only with the travel industry in general, but with the route at issue in particular; (2) the plaintiff was selected to act as defendant's general service agent due to the prior experience of the principals;

and (3) the plaintiff submitted evidence of prior sales for the routes at issue. Here, in contrast, Blackwell had no prior experience in the game industry and *Clever Endeavor* was a new game.

Finally, MindGames invokes *Milex Products v. Alra Laboratories, Inc.*, 237 111. App. 3d 177, 603 N.E.2d 1226 (1992), where the court awarded lost profits to a new manufacturer of a fungible drug that its competitors had been manufacturing for years. The basis for this ruling was the fact that "while the product is a new one, the evidence showed it to have an established market." Id at 1237. A subsequent Seventh Circuit decision not only reaffirmed the New Business Rule under Illinois law, it distinguished Milex because "the plaintiff could estimate its lost profits by using the pre-breach profit history of its competitors" who sold a fungible drug. *Stuart Park Associates, Ltd* **v.** *Ameritech Pension Trust,* 846 F. Supp. 701, *aff'd* 51 F.3d 1319, 1328 (7th Cir. 1995).

Once again, not only do the facts presented here differ significantly from those in *Milex,* the *Milex* opinion actually cuts against MindGames' argument. The product at issue in *Milex* was not innovative but rather had the same active ingredients and worked as well as the innovator's products (*i.e.*, it was essentially a generic form of the original drug). In contrast, MindGames itself admits that *Clever Endeavor* was unique, not fungible.

- Q: Did you think any games were similar to yours?

> A: No. In my opinion ours was differentiated from other games. (Blackwell Dep. 93.)

- Blackwell prepared his 1989 sales projections on orders received at the 1989 Toy Fair and *Clever Endeavor's* reception in the marketplace, not on the sales history of any other game. (Blackwell Dep. 105.)
- Blackwell "think[s] every game is unique." (Blackwell Dep. 134)

MindGames not only invokes inapposite authority, it neglects to mention that the Seventh Circuit found a venture's past successes with a different product in the same business did not render the New Business Rule inapplicable:

> Summit argues vehemently that its successes with other apartment buildings should be considered as probative of [the profits that the proposed apartment complex would yield.] However, these are different pieces of real estate from different markets - not providing a self-evident basis for generalization.

Stuart Park, supra,. 5I F.3d at 1328. Although *Stuart Park* was decided under Illinois law, Illinois (like Arkansas) adheres to the New Business Rule.

1. Lost Royalties Are Lost Profits.

MindGames tries to elude the grasp of the New Business Rule by claiming that it is not asserting a claim for

lost profits. (MindGames' Br. at 2, 9-10.) This argument is simply disingenuous. MindGames' complaint states a claim for lost profits:

> The breaches of the agreement by Western and Games Gang, Ltd. have caused substantial damages, both present and future, to MindGames, ***including loss of profits*** and interference with MindGames' business relations.

(MindGames Cpt. at ¶ 8, attached hereto as Exhibit C.) Consistent with its complaint, MindGames' counsel recently characterized the damages MindGames seeks from lost future sales as lost profits:

> As to MindGames' claim for up to $40 million in ***lost future profits*** based on Western's and Games Gang's mishandling of *Clever Endeavor,* you will say we will not be able to seek such damages because Arkansas is a "New Business Rule" state. (See, February 22, 1996 letter from Camp Kersten to Wendi Sloane Weitman, attached hereto as Exhibit D.)

Even without its admissions to the contrary MindGames' attempt to create a distinction between "***profits***" and "***royalties***" would still be unsuccessful. MindGames invokes the Black's Law Dictionary definition of ***"profit"*** to support its claim that royalty income is not profit. (MindGames' Br. at 10). However, MindGames neglected to cite the Black Law Dictionary definition of

"royalty," which demonstrates the speciousness of MindGames' argument:

> Royalty is share of product or ***profit*** reserved by owner for permitting another to use the property. In its broadest aspect, it is share of ***profit*** reserved by owner for permitting another the use of property. *(Emphasis added)*

It is not surprising that MindGames cites no decision that draws a distinction between profits and royalties. The courts treat a claim for lost royalties as a claim for lost profits. *See, eg., Oral-X Corp.* **v.** *Farnam Companies, Inc.*, 931 F.2d 667, 670 (10th Cir. 1991) (reversing the district court's refusal to award damages for royalties as lost profits); *In re Mid-America Corp.*, 159 B.R. 48, 55 (M.D. Fla. 1993) (holding that the speculative nature and difficulty in determining the amount of lost profits precluded franchisor's recovery of damages for lost future royalties).

Blackwell's own deposition testimony also contradicts the claim that MindGames did not equate royalties with profit. During questioning concerning sales of the *Clever Endeavor* in Europe by foreign licensees, Blackwell described his expectations for the foreign versions of *Clever Endeavor:*

> That ***we would make a profit,*** because I wanted to make sure they [the licensees] made a profit and we would get a continuing ***royalty income***. . . . It was incremental income. There was very little cost income

> from our standpoint -- additional cost, I should say.

(Blackwell Dep. 51.) This testimony makes clear that, until he became aware of the New Business Rule, Blackwell himself considered royalty income to constitute profit to MindGames regardless of whether MindGames itself was incurring any costs of operation.

A. The Facts That *Clever Endeavor* Had No History of Profits And That *Clever Endeavor Is* An Entertainment Product Constitute Additional Reasons For This Court To Adhere To The New Business Rule.

In its initial brief, Western submitted legal and factual support for the argument that because MindGames had no profits prior to the License Agreement, it cannot obtain alleged lost future profits. In response, MindGames cannot and does not dispute that it earned no profits whatsoever prior to the License Agreement. Nor does it address the legal authority Western cites in support of this position. (See Western Br. at 16-17.)

Instead, MindGames takes issue with the proposition that the success of a new entertainment product is especially difficult to predict. MindGames misconstrues rather than refutes Western's argument. MindGames characterizes Western's argument as standing for the proposition that a plaintiff can never recover lost profits in the entertainment business. (MindGames' Br. at 16.) Yet this is not the argument Western advances. Rather in its initial brief, Western argued that, even if this Court were inclined to

retreat from *Marvell Light,* the facts of this case present a particularly inappropriate context in which to do so, given the capriciousness of the entertainment industry. (See Western Br. at 12.) MindGames now appears to take issue with the proposition that the success of entertainment products is particularly difficult to predict. MindGames fails to defend its position with either appropriate factual or legal support.

Ironically, MindGames first chastises Western for failing to produce "a shred of evidentiary support for its argument" (MindGames' Br. at 16.) In fact, Western cited both documentary and testimonial support for this argument (See Western Br. at 13-14, Appendix; Exh. A, H, I, J, N.)

MindGames then insinuates that Western's legal authority does not support its argument. (MindGames Br. 16-18). MindGames tries to distinguish only three of the cases Western cites. Each of these cases -- *Proteus Books Ltd v. Cherry Lane Music Co.,* 873 F.2d 502 (2nd Cir. 1989) (New York law), *Kenford Co. v. County of Erie,* 67 N.Y.2d, 493 N.E.2d 234 (1986) (New York law), and *Haddi Caddy, Inc. v. American Home Products. Corp.,* 557 F.2d 136 (8th Cir. 1977) (Missouri law) -- was decided in a jurisdiction that does not follow the New Business Rule. Western relies on these cases not for the proposition that the New Business Rule applies but instead for the premise that even in states rejecting the New Business Rule, it is difficult to prove lost profits in the entertainment industry. In each case, the court ***rejected*** the lost profits claims because of the speculative nature of the entertainment industry. Significantly, MindGames simply ignores the

Hillside Enterprises decision, discussed at length in Western's brief. (Western Br. at 14-15.)

Finally, MindGames misplaces its reliance on *Jim Halsey Co. v. Bonar, supra.* As discussed above, that case involved a preexisting business (a concert promoter), who presented evidence of his reputation, and ticket sales based on an average vacancy rate. These facts are very different from trying to predict the sales of a new adult board game, which its own inventor characterizes as "unique," by a company where that game was its "first and only product." (Blackwell Dep. 34,134.)

CONCLUSION

For the reasons cited in its initial brief and herein, Western respectfully requests that this Court grant its motion for partial summary judgment and find that MindGames cannot recover its alleged lost profits as a matter of law.

EXCERPTS from

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.,

Plaintiff,

v. Case No. 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

v. Case No. 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

AFFIDAVIT OF G. LAWRENCE BLACKWELL, III, IN OPPOSITION TO THE SUMMARY JUDGMENT MOTION OF WESTERN PUBLISHING COMPANY, INC.

CONTRACT BREACHES BY WESTERN AND GAMES GANG

26. Western breached ¶ 8 of the license agreement (App. 32-33) in the area of its manufacturing responsibilities, including the following:

a. Western negligently printed 50,000 boxes in an incorrect color with poorly printed box wraps. It nevertheless insisted on selling them because of tight schedules. The unappealing boxes caused confusion and dissatisfaction among retailers and consumers in *Clever Endeavor*'s start-up year.

b. Western knowingly sold *Clever Endeavor* games with defective board pieces it had purchased at a 50% discount without timely disclosing to MindGames either the defects or the discount. This also proved very damaging to *Clever Endeavor* in its critical start-up year.

c. Western sold numerous games with missing components, such as game rules, board pieces and venture cards, and with incorrectly cut and duplicated clue cards.

27. Western and Games Gang committed numerous breaches of the license agreement with respect to their promotion, sales and marketing obligations which proved fatal

for *Clever Endeavor*. In October 1990, *Clever Endeavor*'s mass market launch season, Games Gang fired its chief executive officer and president, its chief financial officer and its vice president of marketing and did not replace them. Its only remaining executives had no significant marketing experience. It appeared to me that Western took no steps to rectify the effects of these events on *Clever Endeavor*. The known breaches of contract and performance warranties in the area of marketing on the part of Western and Games Gang include the following:

a. Unknown to MindGames, in May 1990 Games Gang proposed lowering its sales force's commissions on *Clever Endeavor*, reducing their incentive.

b. Without MindGames' consent and without adequate funds, Games Gang promised retailers television ads. Retailers ordered in reliance on this. Games Gang then reneged, causing retailers to cancel orders in large numbers.

c. Without obtaining MindGames' required consent, retailers were notified on December 31, 1990 of a price increase of nearly 17%. A "correction letter"

cancelling the increase was not sent until three months later.

d. Games Gang ran *Clever Endeavor* ads for the critical mass market introductory Christmas season of 1990 late. This caused retailers to panic and seek to escape from an over-inventory position. The late advertising also greatly reduced reorders.

e. Radio ad campaigns in important markets like Chicago and Minneapolis were poorly handled. Ads ran too long and became stale and were not as represented.

f. Ad funds were wasted by running ad campaigns on wrongly-targeted radio stations (as if advertising a rock-related product on an "elevator music" station).

g. Games Gang permitted the public relations firm it selected to fail to perform promised public relations activities.

h. In 1990, 1993 and 1994 Western and Games Gang failed

to spend the minimum amount for advertising required by the license agreement.

i. In 1991, 1992 and 1993 Western ignored MindGames' requests for information on planning and execution of ad campaigns.

j. Western repeatedly gave preference over *Clever Endeavor* in manufacturing and distribution to its other games. This also occurred with respect to derivative *Clever Endeavor* products such as a second edition and a children's edition. MindGames believes this was due to the higher royalties payable on *Clever Endeavor*.

MINDGAMES' DAMAGE CLAIMS

28. I am informed that Western's summary judgment motion attempts to bar MindGames, Inc., from seeking "lost profits" on the ground that Arkansas law does not permit a "new business" to recover "lost profits." MindGames does not claim "lost profits" in this case but rather claims loss of royalties (and other damages) based upon the failure of Western and its co-licensee, Games Gang, to fulfill their obligations under the license agreement.

MindGames' damage claims at the present time are set forth below.

29. MindGames' first claim for royalties is based upon the fact that Western continued to manufacture and sell *Clever Endeavor* throughout 1993, after the initial three-year term of the license. MindGames believes that Western became obligated under the license agreement to pay MindGames the difference between $1.5 million and the royalties actually paid during the first three years by so doing. Despite Western's recent invention, there was no agreement to the contrary and MindGames relied on the 1990 agreement. Western has paid royalties to date of approximately $535,000 for that period. It therefore still owes MindGames approximately $965,000, plus interest. MindGames has never waived its claim to these royalties.

30. MindGames' second claim for royalties is based upon the fact that Western continued to manufacture and sell *Clever Endeavor* through June of 1994, after the first one-year license extension period. By selling the game through a second extension period Western became obligated to pay MindGames additional royalties on sales during the first one-year extension. Western has paid only part of this obligation and owes MindGames the balance, plus interest. Sales made by Western subsequent to January 31, 1994 were not pursuant to a permitted liquidation. Further, most unit sales for the year ending January 31, 1995 occurred after any such liquidation period would have expired. MindGames has not waived its claim to these royalties.

31. MindGames' third claim for royalties is based upon the fact that Western sold about 61,000 copies of *Clever Endeavor* in June 1994. The royalties payable to MindGames on these sales have not all been paid. The balance is owed to MindGames, plus interest.

32. MindGames' fourth damage claim is based upon the fact that Western breached its obligation to obtain MindGames' consent to sell games for less than $16.95 per game when it liquidated many thousands of copies of the game at $4. MindGames did not consent and would not have consented to such a liquidation because of its destructive effect. This liquidation destroyed *Clever Endeavor* as a commercially viable game and any possibility of licensing it to another business was substantially impaired.

33. MindGames further claims damages for Western's failure to disclose material facts regarding Western's assumption of Games Gang's contractual obligations. As required by the license agreement, Western obtained MindGames' permission to assume all of Games Gang's obligations and benefits under the license agreement in 1992. Western failed to disclose, however, that it had to give up a substantial percentage of commissions to Games Gang on all future sales. This seriously impaired Western's incentive to aggressively market *Clever Endeavor*. Western and Games Gang had already expressed to me their concern about "low profits." Had MindGames known the assumption agreement would reduce the profitability of *Clever Endeavor* for Western, MindGames would not have consented to those terms.

34. MindGames also claims damages based upon Western's failure to spend required amounts on advertising and promotion. It owes MindGames 50% of all such unspent funds. The amount of this claim is undetermined at this time, pending further discovery.

35. MindGames' largest damage claim (the only one addressed by Western's motion for summary judgment) is based upon the multiple breaches of contract by Western and Games Gang in manufacturing and marketing *Clever Endeavor* referred to above, the effect of which was to destroy the value of the game in the marketplace and to prevent it from reaching even a fraction of the potential that was widely recognized for it when the license agreement was entered into. The accumulation of breaches by Western and Games Gang made it impossible for *Clever Endeavor* to reach more than a small fraction of the royalty income it had been well on its way toward generating. MindGames' damages for this element are substantial and depend on how closely the jury believes *Clever Endeavor* would have approached the royalty levels of *Pictionary* and *Trivial Pursuit* had it been handled as the licensing agreement required.

EXCERPTS from

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.,

Plaintiff,

v. Case No. 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

v. Case No. 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

SUPPLEMENTAL AFFIDAVIT OF G. LAWRENCE BLACKWELL, III, IN OPPOSITION TO (1) NEW ISSUES RAISED IN WESTERN'S SUMMARY JUDGMENT REPLY BRIEF, (2) WESTERN'S RESPONSES TO MINDGAMES' PROPOSED FINDINGS OF FACT AND (3) WESTERN'S MOTION TO STRIKE SUMMARY JUDGMENT AFFIDAVIT

(b) ¶ 24. Based upon my personal observation and experience as president of MindGames, I know that an estimate of sales will provide an accurate estimate of MindGames' damages because MindGames received royalties based upon sales at virtually no cost to itself. As a businessman, I am aware that sales predictions can be made based upon reasonable supporting evidence. I know that Western made sales predictions for *Clever Endeavor* on which it based its game inventory buildup for supplying the market and avoiding product shortages. Western undoubtedly made such sales predictions for its games every year since at least 1990. WP-1604 (App. 1) shows that in or before April of 1991 Western and Games Gang made sales predictions for their jointly handled games for fiscal 1993. Furthermore, WP-2040 (App. 4) shows that Western predicted its profit on *Clever Endeavor*. Western has not provided unredacted copies and supporting detail for either its own or Games Gang's forecast of *Clever Endeavor* profits after it licensed the game, but WP-1793 and 1794 (App. 6 and 7) indicate the forecasts were made.

Excerpts from

MEMORANDUM OF MINDGAMES, INC., IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT OF WESTERN PUBLISHING COMPANY, INC.

It is important to keep the point of Western's summary judgment motion in sharp focus. It is that the new business rule prevents MindGames from proving "lost profits" as a matter of law. Western argues, in other words, that Arkansas law does not allow MindGames even to attempt to prove the fact and/or the amount of its damage simply because MindGames itself is a new business. (From p. 2.)

* * * * *

Under the applicable law cited later in this brief it is MindGames' obligation to prove its damages to a reasonable certainty. MindGames acknowledges its obligation to establish its claims by appropriate evidence beyond the boundary of speculation and guesswork and looks forward to the opportunity to do so. Meanwhile, Western has not proposed a single fact or offered any evidence beyond the mere unsupported opinions of its lawyers establishing that, as a matter of law, MindGames will be unable to fulfill its burden. On this motion we are not arguing the sufficiency proof, but whether MindGames has the right to present proof. Clearly it has that right, which requires denial of the motion for summary judgment. (From pp.3-4.)

(3)

Supreme Court, U.S.
FILED
DEC 22 2000
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No. 00-825

In The

Supreme Court of the United States

MINDGAMES, INC.,

Petitioner,

v.

WESTERN PUBLISHING COMPANY, INC.,

Respondent.

On Petition For Writ Of Certiorari
To The Court Of Appeals For The Seventh Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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194 PP

QUESTIONS PRESENTED FOR REVIEW

1. Did the Seventh Circuit improperly deprive MindGames of the opportunity to present evidence that its lost profits claim was not unduly speculative by affirming the dismissal of that lost profits claim on a ground raised before the district court but not relied upon by the district court?

2. In affirming the district court's decision, did the Seventh Circuit improperly rely on reasonable inferences it made in Western's, rather than MindGames', favor?

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STATEMENT OF THE CASE

A. Nature of the Case and Course of Proceedings Below.

This appeal arises from a dispute between MindGames, Inc. ("MindGames"), the inventor of a new adult board game called *"Clever Endeavor,"* and Western Publishing Company, Inc. ("Western"), the company given the exclusive license to manufacture and market the game (the "License"). MindGames claims it lost over $40 million in future profits because of Western's alleged breaches of the License.

In its first partial summary judgment motion, Western sought to dismiss MindGames' $40 million lost profits claim. Western first argued that Arkansas law, which controlled the License, adheres to the "New Business Rule," which erects a *per se* ban precluding an unestablished business from recovering lost profits and precluding an established business from recovering lost profits from a new product or venture. Western also argued that, notwithstanding the New Business Rule, MindGames' lost profits claim should be dismissed because, with no history of past profits, "MindGames lacked a reasonable basis to demonstrate its alleged lost profits with reasonable certainty." (R. App. 20.)[1]

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[1] Western's Memorandum in Support of its Motion for Partial Summary Judgment, without exhibits, is submitted here as part of Respondent's Appendix ("R. App.") at 1-17. Other relevant documents and pleadings cited in this brief are also included in the Respondent's Appendix.

On October 11, 1996, the district court granted Western's motion and dismissed MindGames' lost profits claim. Relying on the Arkansas Supreme Court's decision in *Marvell Light & Ice Co. v. General Electric Co.*, 162 Ark. 467, 259 S.W. 741 (1924), Judge Warren held that Arkansas adheres to the New Business Rule as a "*per se* measure to completely prevent the recovery of any profits." *Western Publishing Company, Inc. v. MindGames, Inc.*, 944 F.Supp. 754, 757 (E.D. Wis. 1996). The district court found that the undisputed facts demonstrated that MindGames was a new business and *Clever Endeavor* was a new product. *Id.* at 759-760. The district court did not address Western's alternative basis for dismissing MindGames' lost profits claim. Judge Warren subsequently denied MindGames' Motion for Reconsideration.

In its second partial summary judgment motion, Western sought to dismiss MindGames' claim that Western owed it approximately $1.2 million in unpaid renewal fees to extend the License past its original term, which expired on January 31, 1993. On February 25, 1998, Judge Adelman granted Western's second motion for partial summary judgment.

MindGames appealed both the district court's October 11, 1996 and February 25, 1998 decisions. On June 22, 2000, in a decision written by Chief Judge Posner, the Seventh Circuit affirmed both the October 11, 1996 and February 5, 1998 district court decisions (the "Opinion"). (R. App. 21.) On July 6, 2000, MindGames filed a Petition for Rehearing and Rehearing *En Banc*, challenging only that portion of the Opinion affirming the dismissal of its lost profits claim (*i.e.*, the October 11, 1996 decision). In its Petition for Rehearing, MindGames argued that the

Seventh Circuit misapprehended the record before the district court and "overlooked" Western's alleged failure to raise the "reasonable certainty" argument upon which the Seventh Circuit relied when it affirmed the district court. (R. App. 45.) *After* expressly requesting Western to respond to MindGames' Petition for Rehearing, the Seventh Circuit denied that petition. (R. App. 62.)

B. Statement of Facts.

1. Preliminary Statement.

MindGames' presentation of the "facts" to this Court is irrelevant, incomplete, and without a single record citation. Although MindGames fails to cite to the source of its "facts," its statement derives almost exclusively from the same self-serving affidavits of its president, Larry Blackwell, that MindGames presented to the district court and the Seventh Circuit. (MindGames' App. 89-98; R. App. 63-98.) Although much of the Blackwell affidavits is contradicted by documents in the record or his sworn deposition testimony, Western need not detail these inaccuracies. Most are irrelevant. "Only disputes over the facts that might affect the outcome of the suit under governing law will properly preclude the entry of summary judgment." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505 (1986); *accord First Indiana Bank v. Baker*, 957 F.2d 506, 508 (7th Cir. 1992) ("Factual disputes that are irrelevant or unnecessary will not be counted.").

The Seventh Circuit based its decision on an uncontroverted record created by the documents and sworn deposition testimony. Western will set forth below these undisputed material facts, which were presented to both the district court and the Seventh Circuit.

2. The Development Of *Clever Endeavor*.

In March 1988, Blackwell formed MindGames to develop and sell a new adult board game he invented called "*Clever Endeavor*." (R. App. 100.) *Clever Endeavor* was MindGames' first and only product. (R. App. 101.)

When he formed MindGames, Blackwell had no prior experience in the game industry or the adult game market. (R. App. 102, 107.) Blackwell believed that *Clever Endeavor* would appeal to the same market and achieve the same success as two other adult board games, *Pictionary* and *Trivial Pursuit*. (R. App. 103-105.) Blackwell had no discussions with anyone in the game industry regarding what features made *Trivial Pursuit* and *Pictionary* successful games. (R. App. 106.)

In the spring of 1989, Blackwell decided to publish *Clever Endeavor*. (R. App. 107.) From the spring of 1989 through the end of the year, MindGames marketed the game itself, promoting it at certain events, advertising on the radio and participating in cooperative advertising with retailers. (R. App. 110-111.) During 1989, MindGames sold approximately 30,000 games, but failed to achieve a profit. (R. App. 109, 114-115.)

3. The Parties Enter Into A License Agreement.

In December 1989, Blackwell met with two representatives from a game company called Games Gang, Inc. ("Games Gang"), the current distributor of *Pictionary*. (R. App. 112-113.) These discussions culminated in an exclusive license agreement dated March 30, 1990 between MindGames, as Licensor, and Western and Games Gang, as Licensees, for the manufacture, marketing, promotion, sale and distribution of *Clever Endeavor* (the "License"). The License provides that it is governed in all respects by Arkansas law. The License, among other things, required Western and Games Gang to pay MindGames royalties based on the number of games sold and to provide a minimum amount of advertising support to *Clever Endeavor*.

The initial term of the original license extended through January 31, 1993. The License provided that it would continue for an additional year (through January 31, 1994), only if the Licensees were not in breach and if the Licensees paid MindGames a "Renewal Amount" of $1.5 million (whether earned or unearned in royalties during the initial term of the License) prior to January 31, 1993.

Although *Clever Endeavor* earned only approximately $600,000 in royalties during the initial term of the License (R. App. 75; *see also* Petition at 5.)[2] and Western did not pay MindGames the balance of the Renewal Amount,

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[2] Citations to MindGames' Petition for Writ of Certiorari will appear as "Petition at ___."

Western continued to act as the exclusive licensee of *Clever Endeavor* from February 1993 through January 31, 1994, pursuant to an agreement the parties reached at the February 1993 Toy Fair. (R. App. 117.) At the conclusion of meetings held at the February 1994 Toy Fair, the parties failed to agree on a future licensing arrangement. (R. App. 120-122.)

SUMMARY OF ARGUMENT

Like most creators of a new product, Blackwell hoped he had the next smash hit when he developed *Clever Endeavor* and created MindGames to manufacture and market it. After he negotiated an exclusive license agreement with Western, he dreamed of millions of dollars in royalties from future sales, and a long and profitable license arrangement. When commercial success of *Clever Endeavor* fell short of these fantasies, MindGames looked for a scapegoat, attempting to achieve through litigation what it could not achieve through business. Four times MindGames has attempted to persuade the courts that it is entitled to pursue a claim for $40 million in lost profits. And four times, the courts have rejected its arguments. Now, MindGames comes to the highest court in the land and, incredibly, asks this Court to resuscitate its "pie-in-the-sky" $40 million lost profits claim.

Confronted with no legitimate basis to challenge Judge Posner's decision, MindGames presents as the basis for its Petition for Writ of Certiorari (the "Petition") an argument that is directly contradicted by the record below. The heart of MindGames' challenge to the Seventh

Circuit decision is its contention that the Seventh Circuit affirmed the dismissal of the lost profits claim on a ground never raised in the district court. MindGames claims that Western never argued to the district court that, notwithstanding the New Business Rule, MindGames' lost profits claims should be dismissed because MindGames could not prove its alleged lost royalties with any reasonable certainty. (Petition at 8-9.) Instead, MindGames asserts that Western's "sole attack on MindGames' claim for lost royalties was the New Business Rule." (Petition at 10.)

The premise of MindGames' argument, however, is simply unfounded. Western expressly raised, as an alternative argument, the very grounds upon which the Seventh Circuit relied. What is most telling, and what MindGames painstakingly avoids mentioning, is that the arguments presented in its Petition are the very arguments MindGames raised to the Seventh Circuit as the grounds for Rehearing and Rehearing *En Banc* – the very arguments the Seventh Circuit considered and rejected.

As Western previously demonstrated to the Seventh Circuit's satisfaction, in its Motion for Partial Summary Judgment, Western not only specifically raised the "reasonable certainty" test as an alternative basis to dismiss MindGames' lost profits claim, but MindGames even responded to this argument, offering two affidavits of its principal in an effort to meet the reasonable certainty standard.

Ultimately, the district court based its decision on a strict application of the New Business Rule, and it was from this ruling that MindGames appealed. The parties

therefore directed their briefing before the Seventh Circuit to the issue of whether under Arkansas law there is a *per se* ban on allowing lost profits to a new business. Nevertheless, Western again argued to the Seventh Circuit that "[e]ven if [the Seventh Circuit Court] were to reject a strict application of the New Business Rule, [the Seventh Circuit] should affirm the dismissal of MindGames' lost profits claim" because MindGames could not prove damages with reasonable certainty. (R. App. 124-126.) MindGames never responded to this argument, as the Seventh Circuit recognized. (R. App. 36.)

Although rejecting the argument that Arkansas would apply the New Business Rule, the Seventh Circuit nevertheless upheld the dismissal of MindGames' claims, holding that under the "reasonable certainty" test, MindGames failed to demonstrate that it could calculate its alleged lost royalties to "even a rough approximation." (*Id.*)

Because MindGames' only real objection to the Opinion is that the basis for the Seventh Circuit's ruling was not encompassed within the record below – an objection that Western previously demonstrated, and will again demonstrate, to be untrue – MindGames' Petition should be denied.

ARGUMENT

I. In Its Partial Summary Judgment Motion, Western Raised Both The New Business Rule And MindGames' Inability To Prove Lost Profits With Reasonable Certainty.

Although rejecting the district court's *per se* application of the New Business Rule, the Seventh Circuit nevertheless affirmed the dismissal of MindGames' lost profits claim, holding that no "rational trier of fact could conclude *on this record* that some specific quantity, or for that matter some broad but bounded range of alternative estimates, of copies of *Clever Endeavor* would have been sold had Western honored the contract." (R. App. 35.) MindGames complains that it was never "called on to file evidence from which a jury could reasonably determine sales *Clever Endeavor* would have achieved" because Western never argued uncertainty of lost sales before the district court, and for this reason, it is entitled to this Court's review. (Petition at 9.) This is untrue.

A. Western Specifically Raised The "Reasonable Certainty" Standard In Its Opening Brief In Support Of Its Partial Summary Judgment Motion.

From its initial brief in support of its motion for partial summary judgment, Western put MindGames on notice that Western believed MindGames' claim for lost profits failed even if the district court rejected a *per se* application of the New Business Rule. Western raised a number of challenges to MindGames' lost profits claim that were not dependent on the New Business Rule.

1. No history of past profits. In its opening brief, Western expressly argued that "even if the [district court] were to reject a strict application of the New Business Rule, this [district court] should still grant Western's motion for summary judgment because MindGames has no history of past profits." (R. App. 19.) Western argued that "MindGames lacked a reasonable basis to demonstrate its alleged lost profits with any reasonable certainty." (R. App. 20.) Western cited to specific undisputed facts in the record, including MindGames' failure to earn any profit. (R. App. 2-6.) Western cited case law where courts in jurisdictions rejecting the New Business Rule nevertheless dismissed claims for lost profits where the plaintiff had no history of lost profits. (R. App. 13-20.)

2. The uncertainty of the entertainment industry. Western also argued to the district court that, notwithstanding the New Business Rule, MindGames' claim for lost profits fails because success of an entertainment product, such as *Clever Endeavor*, is inherently uncertain, remote and speculative. (*Id.*) In support of this argument, Western cited to decisions arising in the entertainment field where the courts did not strictly apply the New Business Rule, but nevertheless found that the evidence introduced by the plaintiffs was insufficient to support any recovery for lost profits. (R. App. 14, citing *Proteus Books, Ltd. v. Cherry Lane Music Co.*, 873 F.2d 502 (2nd Cir. 1989) (affirming district court's decision to vacate jury's damages award because, *inter alia*, inherent uncertainties of predicting profits in the entertainment industry made prospective sales of book publisher difficult, if not impossible to calculate) and *Kenford Co. v. County of Erie*, 67 N.Y.2d 257, 493 N.E.2d 234 (1986) (court found plaintiff's

evidence of prospective profits of new stadium insufficient to support any recovery for lost profits); *see also* R. App. 18-19, fn. 3.)

3. The requirement of proving damages with reasonable certainty. In its opening brief, Western discussed at length the Eighth Circuit's decision in *Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410 (8th Cir. 1995), a case also relied upon by the Seventh Circuit in its decision. (R. App. 17-18.) In *Hillside*, the Eighth Circuit, while *not* adopting a *per se* bar to the admission of evidence regarding lost profits by a new business, affirmed the district court's decision to exclude the plaintiff's evidence of its alleged future sales because the evidence plaintiff wanted to introduce was too speculative. 69 F.3d at 1414.

In further support of its assertion that MindGames could not meet the "reasonable certainty" standard, Western argued that numerous factors other than Western's alleged breaches could have affected *Clever Endeavor*'s sales, such as the play value of the game, the number of similar adult board games in a competitive market and the decision by *Clever Endeavor*'s inventor, Mr. Blackwell, to reject television advertising in favor of radio advertising. (R. App. 14-16.) Western further demonstrated that Mr. Blackwell himself conceded that the game industry is especially susceptible to the unique tastes of the average consumer and also admitted the inherent difficulties of marketing a successful game. (R. App. 14.) Western proffered these arguments to illustrate that whether by a strict application of the New Business Rule or by the inherent uncertainty of future sales by *Clever Endeavor*, the only reasonable conclusion that could be drawn by

the district court is that MindGames' lost profits claim fails.

B. MindGames Attempted To Refute Western's Non-New Business Rule Arguments.

Contrary to what MindGames would have the Court believe today, MindGames knew from the beginning that Western had challenged MindGames' ability to demonstrate its alleged lost royalties with any certainty. In its brief filed in opposition to Western's partial summary judgment motion, MindGames conceded, "Western argues, in effect, that no matter how badly it botched the handling of *Clever Endeavor*, no matter how egregious its failures under the contract, MindGames cannot claim damages for lost royalties because 'entertainment products' are too speculative." (R. App. 144.)

Having acknowledged that Western challenged its right to lost profits on this alternative basis, MindGames then raised both legal and factual arguments in response. Although it made no attempt to challenge the *Hillside Enterprises* decision, MindGames did attempt to distinguish the *Proteus Books, Ltd.* and *Kenford Co.* cases. (R. App. 144.) Although it did not and could not challenge the impact of its unprofitable track record, MindGames challenged Western's suggestion that factors other than Western's alleged breaches caused the less than stellar sales of *Clever Endeavor*, and asserted that the fact that *Clever Endeavor* "made it to the shelf" and "lasted more than two years" somehow brings the success of *Clever Endeavor* "out of the realm of speculation." (R. App. 146.)

MindGames also attempted to introduce evidence to support its claim that its damages could be proved with reasonable certainty. MindGames submitted not one, but two, affidavits from Mr. Blackwell, comprising forty-one pages of Mr. Blackwell's alleged personal knowledge of facts relating to *Clever Endeavor*. (R. App. 63-98.) In these affidavits, Mr. Blackwell, among other topics, described the alleged contract breaches by Western *and* the alleged damages suffered by MindGames as a result of those breaches. (R. App. 72-77.) Mr. Blackwell even proffered a basis by which the district court could estimate MindGames' alleged lost profits.[3] (R. App. 77, ¶35.)

Having specifically responded to this argument at the district court level, it is nothing short of astounding that MindGames seeks the extraordinary relief of a hearing before this Court by claiming that "MindGames was never called on to file evidence from which a jury could reasonably determine sales *Clever Endeavor* would likely have achieved had Western performed." (Petition at 9.)

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[3] The inherently speculative nature of MindGames' lost profits claim becomes even more evident in light of its repeated assertion that it seeks approximately $40 million in lost profits – an assertion that was raised even at the district court level. (R. App. 7, 149-150.) If MindGames actually employed a methodology to arrive at this astronomical number, one has to assume that this methodology would have been included in the voluminous affidavits submitted by Mr. Blackwell. However, MindGames provided no such methodology. The only logical inference is that its $40 million claim is based not in fact but in its own pie-in-the-sky optimism that its game would have enjoyed the same success as *Trivial Pursuit* and *Pictionary* – the only exceptionally successful adult board games to emerge in recent history from the plethora of games introduced each year.

While the district court ultimately granted Western's motion for partial summary judgment based on a *per se* application of the New Business Rule, it did so on a record that contained Western's alternative argument – that MindGames' lost profits claim was too speculative to survive a motion for summary judgment even if Arkansas did not adhere to the New Business Rule. This record was included in the record on appeal, on which the Seventh Circuit based its decision. Because the basis for the Opinion was expressly raised before the district court, MindGames' Petition is without merit and should be summarily dismissed.

II. MindGames' Other Arguments In Support Of Its Petition Similarly Fail.

Based on the demonstrably false assertion that Western never raised the "speculation" issue before the district court, MindGames argues: (1) the Opinion conflicts with authority from this Court; (2) the Opinion is somehow improper because the basis for the Seventh Circuit's affirmance was not an "issue" presented by either party; (3) MindGames' due process rights have been violated; and (4) the Seventh Circuit improperly drew controlling inferences against MindGames. These arguments fare no better than MindGames' primary one, and further demonstrate that MindGames' Petition is wholly without merit.

A. The Opinion Does Not Conflict With *Celotex* Or Its Progeny.

MindGames concedes, as it must, that the Seventh Circuit has the power to affirm a district court's decision on alternative grounds as long as those alternative grounds are supported by the record. (Petition at 16.) *See Flynn v. Sandahl*, 58 F.3d 283, 289 (7th Cir. 1995). Nor does MindGames dispute that the Seventh Circuit exercises plenary review over a district court's grant of summary judgment, drawing its own conclusions of law and fact from the record before it. *Noreuil v. Peabody Coal Co.*, 96 F.3d 254, 257-258 (7th Cir. 1996).

While not challenging these standards, MindGames argues that the Seventh Circuit's decision conflicts with this Court's decision in *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), and for this reason the Court should grant the Petition. MindGames argues that "while the *Celotex* court ruled an evidentiary record is not always required of the movant in order to call upon the nonmovant to present a record demonstrating a material issue of fact, the court held notice must at least be given of all issues on which the *nonmovant* is being required to make an evidentiary record." (emphasis in original) (Petition at 16.) Relying on this passage from *Celotex*, as well as Judge Bork's dissenting opinion in *Catrett v. Johns-Manville Sales Corporation, et al.*, 756 F.2d 181 (D.C. Cir. 1985), MindGames leaps to the conclusion that it failed to receive sufficient notice of Western's "reasonable certainty" argument. (Petition at 17-18.)

First, MindGames' summary of the *Celotex* ruling is misleading at best. As aptly pointed out by one of the leading treatises in this area, the *Celotex* court:

> implicitly recognized [that] the power of the [district] court to render summary judgment *sua sponte* supports the conclusion that the moving party on a summary judgment motion need not produce evidence, but simply can argue that there is an absence of evidence by which the nonmovant can prove his case.

Wright & Miller, Federal Practice and Procedure, § 2720, p. 345 (1998); 477 U.S. at 325-326. Thus, contrary to MindGames' bald summation, *Celotex* does not require that the non-movant must receive "fair notice" of the evidentiary record it is being called upon to meet.[4]

Second, Judge Bork's dissenting opinion in *Catrett* has no bearing on these proceedings, other than to confirm that Western did not have the burden "to produce evidence showing the absence of a genuine issue of material fact." 477 U.S. at 325. Neither the Court in *Celotex* nor Judge Bork[5] in his dissent in the *Catrett* opinion,

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[4] Nor did the Court in *Blum v. Bacon*, 457 U.S. 132 (1982) or *Schweiker v. Hogan*, 457 U.S. 569 (1982) address this issue or even use the term "fair notice," as MindGames would have the Court believe. (Petition at 16.)

[5] Not surprisingly, Judge Bork's dissenting opinion, which MindGames relies upon so heavily, lends support to *Western's* position. In his dissent, Judge Bork supported the district court's decision to grant summary judgment and emphasized that a party's failure to recognize that it was being called upon to produce admissible evidence that would create a factual dispute or seek more time to obtain such evidence does not

addressed, much less discussed, the issue here – the standard for determining whether the ground upon which the appellate court relied was adequately presented to the district court so as to put the non-movant on "notice" that it had to, if it could, submit evidence to contest that ground. Indeed, the references to "notice" by this Court and Judge Bork were given in the context of a district court granting summary judgment *sua sponte* and, therefore, are irrelevant to the issues raised in MindGames' Petition.

Third, as MindGames is well aware, Western has met the applicable "notice" standard, which has been articulated in *Box v. A&P Tea Co.*, 772 F.2d 1372 (7th Cir. 1985). In its Petition for Rehearing, MindGames argued that the Opinion conflicted with the Seventh Circuit's prior decision in *Box*. MindGames claimed that, under *Box*, the appellate court cannot affirm a district court ruling unless the grounds for that ruling were adequately presented in the district court so that the non-movant had an opportunity to submit contrary evidence. (R. App. 50.) Relying on *Box*, MindGames argued that the Opinion created a conflict in the Seventh Circuit because the majority had affirmed the district court on a ground not "adequately presented" to the district court. (R. App. 50-51.)

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preclude the court from granting summary judgment against that party. *Catrett*, 756 F.2d at 191. Because, as discussed *supra*, Western argued that MindGames could not demonstrate its lost profits with reasonable certainty, Judge Bork would likely agree with the Seventh Circuit's decision and avoid "the judicial impulse to save [MindGames'] case from what may have been careless preparation." *Id.*

It is not surprising that MindGames now abandons its reliance on *Box*. As Western pointed out in its response to MindGames' Petition for Rehearing, not only is *Box* broader than MindGames suggested, but the Seventh Circuit Opinion here easily complies with the standard articulated in *Box*.

The Seventh Circuit in *Box* held that

> "[this Court] can affirm a summary judgment on any ground that finds support in the record, but the ground must have been adequately presented in the trial court so that the non-moving party had an opportunity to submit affidavits or other evidence and contest the issue. Analogously, we may affirm a summary judgment on a ground not raised in the trial court if the grounds asserted in the trial court necessarily *encompass* the ground asserted on appeal." (emphasis added) *Box*, 772 F.2d at 1376.

The record before the district court in *Box* provided far less notice of the arguments upon which the appellate court ultimately affirmed the dismissal of the plaintiff's claims. There, a former employee brought a sex discrimination action against her employer. The employer moved for summary judgment on the grounds that (1) the employee failed to raise a claim of sex discrimination in her complaint to the Equal Employment Opportunity Commission ("EEOC") and (2) that all persons who received the jobs the employee claimed she was denied were female. The district court granted the employer's motion for summary judgment for both reasons, and the employee appealed.

On appeal, the Seventh Circuit found that neither ground relied upon by the district court justified summary judgment for the employer. The Seventh Circuit found that the second ground was not well founded because the employee had made the additional argument to the district court that the employer discriminated against her by not training her or promoting her to an assistant manager position. Nevertheless, the *Box* court affirmed the district court's decision because, as pointed out by the employer on appeal, the plaintiff never offered any evidence that she had ever *applied for* the assistant manager position, and, therefore, the employee could not demonstrate a *prima facie* case of sex discrimination.

The employee contended that the Seventh Circuit should not consider the merits of the argument that she failed to apply for the assistant manager position because the employer never made that argument before the district court. The *Box* court disagreed. The Seventh Circuit found that in the employer's initial memorandum the employer argued, in general, that the employee could not show a *prima facie* case of sex discrimination. *Id.* Although the argument relied upon by the court in *Box* was not argued by the employer before the district court "as elaborately" as the two arguments relied on by the district court, the Seventh Circuit found that the argument was *encompassed* in the record and could be considered on appeal. *Id.*

Here, the ground relied upon by the Seventh Circuit to affirm the district court's decision, *i.e.*, the "reasonably certainty" argument or "speculation" issue, was certainly *encompassed* within the record before the district court, in much greater detail than the ground relied upon by the Seventh Circuit in *Box*. Western expressly raised this

argument and challenged MindGames to put forth evidence by which it could demonstrate its alleged lost profits with reasonable certainty. As the Seventh Circuit recognized, MindGames failed to submit such evidence. Therefore, the Seventh Circuit's decision is consistent with the applicable standards for "notice" to a nonmoving party set forth in *Box* and its progeny.

B. It Is Irrelevant That The Basis For The Opinion Was Not An "Issue" Presented By Either Party.

MindGames also argues, with no legal support, that because the issues presented for review to the Seventh Circuit did not include the ground relied upon by the Seventh Circuit, the "reasonable certainty" argument could not have been raised below. (Petition at 13-14.) The lack of authority for this proposition is not surprising because such a rule would make no logical sense. Because the district court relied on a *per se* application of the New Business Rule, the statement of issues presented for review necessarily related to the grounds relied upon by the district court in its decision.

There is no rule mandating, or even suggesting, that all possible grounds for affirming or reversing a district court's decision must be included within the statement of issues presented to the Seventh Circuit. Nor could such a rule exist. In reviewing a grant of summary judgment, the appellate courts are to conduct a *de novo* review of the proceedings and the record below. *Miranda v. Wisconsin Power & Light. Co.*, 91 F.3d 1011, 1014 (7th Cir. 1996). Limiting the grounds upon which the appellate court could affirm a summary judgment ruling to those stated in the "Issues Presented" section of the briefs would

essentially preclude the appellate court from making a *de novo* review of the record.

MindGames, moreover, mistakenly claims that "the majority then referred to an argument Western presented to the court of appeals – not to the district court – and concluded the 'argument was brief but not so brief as to fail to put MindGames on notice of a possible alternative ground for upholding the district court's judgment.' " (Petition at 14.) As explained above, MindGames' claim is simply untrue.

C. MindGames Misapprehends The Opinion, Western's Burden And The Responsibilities Of The District Court.

In a thinly-veiled attempt to satisfy the strict standards of Supreme Court Rule 10, MindGames expands the Opinion beyond its limited holding and argues that its due process rights have somehow been violated – all in the hope that it will convince the Court that its case is worthy of being heard. MindGames then proceeds to impose burdens on both the district court and Western that have no support whatsoever in the law.

MindGames would have this Court believe that the ruling of the Seventh Circuit "puts summary judgment nonmovants in an almost impossible position and forces them to prove every element of their cases at the summary judgment stage lest the court of appeals dismiss for lack of evidence on a ground not raised by the movant, not ruled on by the district court and without the responding party having been notified of the need to produce evidence." (Petition at 8.) MindGames' assertion is pure fiction.

First, let there be no doubt, Western raised the "reasonable certainty" argument in its initial motion for partial summary judgment. Moreover, contrary to the self-serving excerpts MindGames quotes from its prior response brief (Petition at 20), MindGames recognized that Western was making this argument. (R. App. 144.) If MindGames chose to "assume [that] defeating application of the 'new business' rule defeated [Western's motion for] summary judgment," it did so at its own risk. (Petition at 20.) Such an improper assumption on the part of MindGames does not change the fact that Western raised the "reasonable certainty" argument before the district court. (Petition at 20.)

Second, the fact that the district court did not address Western's "reasonable certainty" argument is irrelevant. It is well-settled that the Seventh Circuit can affirm a district court's decision on alternative grounds, not ruled upon by the district court, as long as those alternative grounds are supported by the record. *Flynn, supra*, 58 F.3d at 289. Nothing in the Opinion is inconsistent with that legal proposition.

Third, contrary to MindGames' apparent belief, neither the district court nor Western had the burden of "notifying" MindGames that it needed to produce evidence to avert summary judgment on its lost profits claim. (Petition at 8, 12, 19.) Indeed, Western's only burden, which it satisfied, was to identify through "pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any," the absence of a genuine issue of material fact. *Celotex*, 477 U.S. at 323. Western was under no obligation to "challenge MindGames to come forward with evidence of

lost future sales." (Petition at 12.) Because the district court did not bring this summary judgment motion *sua sponte*, it also had no duty to notify MindGames that it had to come forward with evidence of its alleged lost profits damages. *Celotex*, 477 U.S. at 326. Rather, MindGames had the burden of recognizing the arguments raised by Western and submitting evidence, if possible, sufficient to create an issue of fact. *Insolia v. Philip Morris Incorporated*, 216 F.3d 596, 598-599 (7th Cir. 2000). Again, nothing in the Opinion contradicts this well established law or forces nonmovants to "prove" their case at the summary judgment stage, as MindGames would have this Court believe. (Petition at 8.)

Finally, MindGames cries that it was deprived of due process and never got its day in court because it did not have "fair notice that it was required to prove its lost profits damages . . . at the summary judgment stage." (Petition at 19.) This argument fails because (1) Western's "reasonable certainty" argument was encompassed within its motion for partial summary judgment and (2) under no circumstances did MindGames have to *prove* its damages. Rather, it had the burden of creating a genuine issue of fact that it could demonstrate its lost profits with reasonable certainty. MindGames conveniently ignores its own burden and the fact that a party is not *entitled* to their "day in court," but must earn that day by demonstrating the existence of a genuine issue of fact or law. The Seventh Circuit correctly found that MindGames did not satisfy its own burden and, therefore, was not entitled to its "day in court" as a matter of law.

D. This Court Must Only Draw *Reasonable* Inferences In MindGames' Favor.

MindGames also argues, as it did in its Petition for Rehearing, that the Seventh Circuit made unwarranted inferences against it and overlooked evidence in the record of Western's wrongful conduct. (Petition at 10-11.) MindGames' arguments are factually and legally deficient.

In arguing that the Seventh Circuit failed to draw inferences in its favor, MindGames, again, improperly takes liberties with the Opinion. MindGames argues that the Seventh Circuit based its decision on two inferences it made in favor of Western: (1) that Western did not market *Clever Endeavor* more vigorously because it correctly sensed that demand had "dried up" (Petition at 22); and (2) MindGames' failure to terminate the License after the alleged breaches occurred and to seek distribution of the game by other means is evidence of a lack of commercial promise unrelated to Western's conduct. (Petition at 24.) MindGames' argument is demonstrably untrue.

A fair reading of the Opinion demonstrates that the Seventh Circuit based its ruling on undisputed facts, including the fact that MindGames had no history of past profits.

> What is important is that Blackwell had no track record when he created "Clever Endeavor." He could not point to other games that he had invented and that had sold well. He was not in the position of the bestselling author who can prove from his past success that his new book, which the defendant failed to promote, would have been likely – not certain, of course – to

> have enjoyed a success comparable to that of the average of his previous books if only it had been promoted as promised. That would be like a case of a new business launched by an entrepreneur with a proven track record. (R. App. 33-34.)

The remaining portion of the Opinion is nothing more than *dicta*. Indeed, immediately after speculating that Western correctly sensed that the demand for *Clever Endeavor* had "dried up," the Seventh Circuit stated:

> Even if that alternative is rejected, we do not see how the number of copies that would have been sold but for the alleged breach could be determined given the evidence presented in the summary judgment proceedings (a potentially important qualification, of course); and so MindGames' proof of damages is indeed excessively speculative. See, e.g., *Gentry v. Little Rock Road Machinery Co.*, 339 S.W.2d 101, 104 (Ark. 1960); *Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410, 1414 (8th Cir. 1995); *K & R, Inc. v. Crete Storage Corp.*, 231 N.W.2d 110, 115 (Neb. 1975); see also *AGF, Inc. v. Great Lakes Heat Treating Co., supra*, 555 N.E.2d at 640. Those proceedings were completed with no evidence having been presented from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter some broad but bounded range of alternative estimates, of copies of "Clever Endeavor" would have been sold had Western honored the contract. MindGames obtained $600,000 in royalties on sales of 165,000 copies of the game, implying that Western would have had to sell more than 10 million copies to generate the $40 million in lost royalties that MindGames seeks to recover. Cf. *Boxhorn's Big Muskego Gun Club, Inc. v. Electrical*

Workers Local 494, 798 F.2d 1016, 1023 (7th Cir. 1986). (R. App. 34-35.)

Moreover, even if the Seventh Circuit had based its ruling, in part, on these inferences, MindGames' argument still fails. Although the Seventh Circuit had to "draw inferences in a light most favorable to the nonmoving party," it was "not required to draw every conceivable inference from the record – only those inferences that are ***reasonable***." (emphasis added) *Shank, et al. v. Hague, Inc.*, 192 F.3d 675, 683 (7th Cir. 1999). A reasonable inference "cannot be supported by only threadbare conclusory statements instead of significant probative evidence." *Barnes v. Arden Mayfair, Inc.*, 759 F.2d 676, 680-81 (9th Cir. 1985).

In its initial brief before the district court, Western challenged MindGames' ability to prove it lost millions in royalties as a result of Western's conduct. The burden then shifted to MindGames to "move beyond the pleadings and to set forth specific facts from which it might be reasonably inferred" that MindGames could satisfy this burden of proof. *See Jenkins v. Heintz*, 124 F.3d 824, 831 (7th Cir. 1997) (affirming summary judgment in favor of attorney and law firm where plaintiff failed to put forth evidence from which one could reasonably infer that defendants knew and intentionally made false representations). As the Seventh Circuit stated in *Schacht v. Wisconsin Dept. of Corrections, et al.*, 175 F.3d 497 (7th Cir. 1999), "[summary judgment] is the 'put up or shut up' moment in a lawsuit, when a party must show what evidence it has that would convince a trier of fact to accept its version of events." 175 F.2d at 504. As the

Seventh Circuit recognized, MindGames did not satisfy its burden.

In its Petition, MindGames continues to refuse to acknowledge its burden as a non-movant to submit evidence from which a reasonable trier of fact could estimate the lost royalties MindGames allegedly incurred as a result of Western's conduct. It asks the Court to find that the district court and the Seventh Circuit had to draw every conceivable inference in its favor, whether reasonable or not, so that MindGames can someday get its case in front of a jury. The law, however, prevents MindGames from getting in front of a jury if it cannot submit evidence that would bring its claim for $40 million out of the realm of mere "speculation, conjecture or fantasy." *Barnes*, 759 F.2d at 681.[6]

III. The Seventh Circuit correctly found that MindGames cannot pass the "reasonable certainty" test.

MindGames would have this Court believe that if the New Business Rule is no longer the law in Arkansas, it

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[6] MindGames' citation to *Eastman Kodak Company v. Image Technical Services, Inc., et. al.*, 504 U.S. 451 (1992) does not change the end result here. The Court's holding in *Eastman* did not in any way restrict the district court's or Seventh Circuit's discretion to draw only reasonable inferences in favor of the non-moving party. Moreover, MindGames again miscites an opinion from this Court. Nothing in *Eastman* indicates that MindGames can pass the "reasonable certainty" test simply by demonstrating that its claims are not "economically senseless." Indeed, MindGames has previously *argued* that the "reasonable certainty" test is the applicable standard. (R. App. 152.)

necessarily gets a shot with a jury. That is not the case. As Chief Judge Posner wrote on behalf of the Seventh Circuit, "abrogation of the 'new business rule' does not produce a free-for all." (R. App. 33.) The New Business Rule is a formalization of a rule designed to ensure that when the undisputed facts fall into a certain category, *i.e.*, a new business with no history of past success, a party cannot recover its lost profits regardless of the alleged breaches. The "reasonable certainty" test, adopted by the majority of states and by the Seventh Circuit here, stands for essentially the same proposition of law. As the Seventh Circuit recognized, there are certain situations where a trier of fact cannot award any damages because such an award would be too remote and speculative based on the undisputed facts. Such a situation is present here, and MindGames knows it.

The key facts are undisputed. Mr. Blackwell had no track record in the adult board game industry when he invented *Clever Endeavor*. MindGames failed to achieve a profit prior to Western's alleged breaches of the license agreement. And, the consuming public, as Justice Posner aptly stated, is "fickle." (R. App. 34.) Both the Seventh Circuit and the district court were presented with these undisputed facts, as well as others. Both courts recognized that, based on these undisputed facts, any estimate of lost profits would be inherently speculative. In reaching its decision, the district court relied on a strict application of the New Business Rule. The Seventh Circuit, while not adopting the New Business Rule, achieved the same end result by finding that no evidence existed in the

record from which a reasonable trier of fact could estimate the number of copies of *Clever Endeavor* that would have been sold but for Western's alleged breaches.

MindGames' continued reliance on the success of *Trivial Pursuit* and *Pictionary* illustrates the Seventh Circuit's point. The fact that Western had marketed these highly successful adult board games does not mean that Western has the "Midas Touch" and every game it markets will turn to "gold." If such an inference was reasonable, as MindGames would have the Court believe, MGM would be sued every time a film it produced did not achieve the same success as "The Wizard Of Oz." MindGames' and Mr. Blackwell's history of success, or lack thereof, in the adult board game industry are the key considerations. Western's prior success with other games is irrelevant. The Seventh Circuit's decision recognized, like other courts have in the past, that the undisputed facts of record demonstrate that MindGames could never pass the "reasonable certainty" test. *See, e.g., Hillside Enterprises, supra; Information Communication Corporation v. Unisys Corporation*, 181 F.3d 629 (5th Cir. 1999) (affirming district court's decision to overturn jury's award of lost profits where plaintiff was a new and improved business, had no track record of successfully creating and marketing new products and had no history of profitability); *Texas Instruments, Inc. v. Telestron Energy Management, Inc.*, 877 S.W.2d 276 (Tex. 1994) (plaintiff did not pass "reasonable certainty" test and could not recover lost profits where new and unique product at issue had never been sold before and plaintiff never operated at a profit.)

CONCLUSION

For all the foregoing reasons, this Court should deny MindGames' Petition in its entirety.

Dated: December 22, 2000

Respectfully submitted,

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No. 00-825

In The

Supreme Court of the United States

MINDGAMES, INC.,

Petitioner,

v.

WESTERN PUBLISHING COMPANY, INC.,

Respondent.

On Petition For Writ Of Certiorari To The Court Of Appeals For The Seventh Circuit

RESPONDENT'S APPENDIX TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC., Plaintiff, v. MINDGAMES, INC., Defendant.	CIVIL NO. 94 C 0552 Hon. Robert E. Warren CIVIL NO. 94 C 0998
MINDGAMES, INC., Plaintiff, v. WESTERN PUBLISHING COMPANY, INC., Defendant.	(Filed May 20, 1996)

WESTERN PUBLISHING COMPANY, INC.'S MEMORANDUM IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT

I. INTRODUCTION

The driving force behind this dispute between MindGames, Inc. ("MindGames") and Western Publishing Company, Inc. ("Western") is MindGames' belief that Western's alleged breach of the parties' license agreement prevented MindGames' new adult board game called *"Clever Endeavor"* from achieving the same success as two of the most successful adult board games of all time, *Pictionary* and *Trivial Pursuit*. Rather than attributing *Clever Endeavor*'s limited success to the erratic whims of

the consumer and the game's own shortcomings, MindGames is determined to place the blame on Western – the exclusive licensee of *Clever Endeavor* for almost its entire shelf life. In so doing, MindGames seeks over $40 million dollars in damages for profits it allegedly lost due to Western's breach of the license agreement. However, MindGames cannot, as a matter of law, recover its alleged lost profits because Arkansas still applies the "New Business Rule," which *prevents* the recovery of *any* lost profits for a new product, such as *Clever Endeavor.* The inherent difficulties of predicting the success of a product in the entertainment and leisure industry further dictate the strict application of the New Business Rule.

Moreover, MindGames' failure to show any history of profitability before its license agreement with Western, provides a second reason that MindGames is legally precluded from recovering any anticipated lost profits. Consequently, Western respectfully requests that this Court grant it partial summary judgment on the portion of MindGames' claim which seeks damages for its alleged lost profits.

II. WESTERN'S PROPOSED FINDINGS OF FACT

A. The Parties.

1. Western Publishing Company, Inc. ("Western") is a corporation organized and existing under the laws of the State of Wisconsin, with its principal place of business located at 1220 Mound Avenue, Racine, Wisconsin.

2. MindGames, Inc. ("MindGames") is a corporation organized and existing under the laws of the State of

Arkansas, with its principal place of business located at 2720 West 28th Street, Pine Bluff, Arkansas.

B. Jurisdiction and Venue.

3. Western and MindGames are citizens of different states and the matter in controversy involves a sum in excess of $50,000, exclusive of interest and costs. Accordingly, this Court has jurisdiction over this action pursuant to 28 U.S.C. § 1332(a).

4. Western has its principal place of business in the Eastern District of Wisconsin, and the causes of action asserted in this lawsuit arose in this District. Venue is therefore proper in this District pursuant to 28 U.S.C. § 1391(a).

C. The Development of *Clever Endeavor.*

5. In March 1988, Larry Blackwell ("Blackwell") formed MindGames for the sole purpose of manufacturing, marketing and selling a new adult board game he invented called "*Clever Endeavor.*" (See p. 24 of the Deposition of Larry Blackwell ("Blackwell Dep."). Copies of the relevant pages of Mr. Blackwell's deposition transcript are attached hereto as Group Exhibit A). *Clever Endeavor* was MindGames' first and only product. (Blackwell Dep. p. 34).

6. At the time Blackwell formed MindGames, he had no prior experience in the game industry or the adult game market in particular. (Blackwell Dep. pp. 46, 84). Nevertheless, Blackwell believed that *Clever Endeavor*

would appeal to the same market and achieve the same success as the two most successful adult board games of their time, *Pictionary* and *Trivial Pursuit*. (Blackwell Dep. pp. 79-81). Blackwell formed this belief without having any discussions with anyone in the game industry regarding what features made *Trivial Pursuit* and *Pictionary* successful games. (Blackwell Dep. p. 82).

7. Prior to its initial distribution of the game in September 1989, MindGames conducted some minimal test marketing of *Clever Endeavor*, such as playing the prototype of *Clever Endeavor* with focus play groups out of Blackwell's parents' and friends' homes. (Blackwell Dep. pp. 160-165).

8. In the spring of 1989, Blackwell decided to publish *Clever Endeavor*. (Blackwell Dep. p. 107). From the spring of 1989 through the end of the year, MindGames marketed the game itself by promoting it at certain events and through radio advertising and cooperative advertising with retailers. (Blackwell Dep. p. 172). MindGames, however, did not use any type of television advertising to promote *Clever Endeavor* because Blackwell did not believe that the cost for such advertising justified the expense. (Blackwell Dep. pp. 174-175).

9. During 1989, MindGames sold approximately 30,000 games, but failed to achieve a profit for that year. (Blackwell Dep. pp. 169; *See*, the 1989 Income Statement for MindGames, a copy of which is attached hereto as Exhibit B).

D. The License Agreement.

10. In December 1989, Blackwell met with two representatives from a game company called Games Gang, Inc. ("Games Gang"), which was the current distributor of *Pictionary*. (Blackwell Dep. pp. 192-193). These discussions culminated on March 30, 1990 when MindGames, as Licensor, entered into an exclusive license agreement with Western and Games Gang, as Licensees, for the manufacture, marketing, promotion, sale and distribution of the *Clever Endeavor* game (the "License"). (A copy of the License is attached hereto as Exhibit C).

11. The License is governed in all respects by the laws of the State of Arkansas. (Exhibit C at ¶ 20).

12. The License, among other things, required Western and Games Gang to pay MindGames royalties based on the number of games sold and to provide a minimum amount of advertising support to *Clever Endeavor*. (Exhibit C at ¶¶ 4, 6).

13. The term of the original License extended through January 31, 1993. (Exhibit C at ¶ 2). The License provided that, if the Licensees were not in breach, the License would continue until January 31, 1994 in the event that the Licensees paid MindGames at $1.5 million (whether earned or unearned in royalties during the term of the License) prior to January 31, 1993. (Exhibit C at ¶ 2). For any renewal term beginning on or after January 31, 1994, the Licensees were required to pay MindGames $300,000, less royalties earned between January 31, 1993 and January 31, 1994. (Exhibit C at ¶ 2).

14. On March 13, 1991, the parties amended the License by allowing the Licensees to reduce the percentage of gross sales to be utilized for advertising and promotion in order to "keep the cost of the game down." A copy of the March 13, 1991 letter agreement amending the License (the "1991 Amendment") is attached hereto as Exhibit D.

15. With the written consent of MindGames, Western assumed the duties and obligations of the other licensee, Games Gang, under the License, pursuant to a sublicense agreement dated February 3, 1992. Western served as the exclusive licensee of *Clever Endeavor* through January 31, 1994.

16. The net sales of Clever Endeavor during the original term of the License were as follows:

Fiscal Year	*Clever Endeavor* Units Sold
FY 1990	165,000
FY 1991	58,113
FY 1992	26,394
FY 1993	7,438

III. NATURE OF THE DISPUTE

MindGames alleges that *Clever Endeavor* was not successful because Western breached the License by, *inter alia*, 1) failing to pay MindGames the minimum royalties necessary to renew the License, 2) failing to properly manufacture and distribute *Clever Endeavor*, 3) failing to "diligently and actively promote and make every reasonable effort to market and sell *Clever Endeavor*" and 4)

failing to provide the minimum amount of advertising support required under the License. (*See*, MindGames' Complaint, a copy of which is attached hereto as Exhibit E). As a result of the alleged breach of the License by Western, MindGames seeks damages against Western in excess of $40 million dollars. (*See*, the April 25, 1995 letter from MindGames' attorney, a copy of which is attached hereto as Exhibit F). MindGames bases almost the entire amount of its damage claim on the profits it allegedly lost due to Western's alleged breach of the License.[1]

IV. ARGUMENT

A. The Standard For Granting Summary Judgment.

Rule 56(c) of the Federal Rules of Civil Procedure deems summary judgment appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Kendrick v. East Delavan Baptist Church*, 886 F. Supp. 1465, 1471 (E.D. Wisc. 1995) (Warren, J.) citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S. Ct. 2505, 2510 (1986); *see, Donovan v. City of Milwaukee*, 845 F. Supp. 1312, 1313 (E.D. Wisc. 1992) (Reynolds, J.). The presence of a genuine issue of material fact is to be determined by the

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[1] MindGames also seeks $1.2 million for royalties allegedly owed to renew the License for the period of February 1, 1993 through January 31, 1994 and for the period of February 1, 1994 through January 31, 1995.

substantive law controlling that case or issue. *Kendrick*, 886 F. Supp. at 1471. Although some facts may be in dispute, entry of summary judgment is in order if the movant either establishes uncontroverted facts entitling it to summary judgment or demonstrates that the non-moving party has failed to make a sufficient showing on an essential element of its case with respect to which it will bear the burden of proof at trial. *Donovan*, 845 F. Supp. at 1314.

The application of Arkansas law to the undisputed facts of this case establishes that MindGames cannot, as a matter of law, recover its lost profits. Therefore, Western respectfully requests that this Court grant it partial summary judgment, and find that MindGames is precluded from seeking damages for its alleged lost profits.

B. The "New Business Rule" Prevents MindGames From Recovering Any Lost Profits.

Western emphatically denies that it breached any of the terms of the License. However, even assuming *arguendo* that MindGames could demonstrate that Western or Games Gang breached any provision of the License, MindGames is legally precluded from recovering its lost profits.

1. Arkansas follows the "New Business Rule."

As a new business, MindGames is barred under Arkansas law from introducing any evidence regarding its lost profits. Arkansas follows the "New Business Rule," which holds that a new or unestablished business

is precluded, as a matter of law, from recovering lost profits. *Marvell Light & Ice Co. v. General Electric Co.*, 162 Ark. 467, 259 S.W. 741 (1924). The Arkansas Supreme Court reasoned that "[t]he anticipated profits of a new business are too remote, speculative and uncertain to support a judgment for their loss." 259 S.W. at 741. *Accord Central Coal & Coke Co. v. Hartman*, 111 F. 96, 98 (8th Cir. 1901).

Although the Supreme Court of Arkansas has not addressed this issue since it decided *Marvell Light* in 1924, there is no reason to believe that the Arkansas Supreme court's [sic] has changed its position on the recovery of lost profits by a new business. Despite exhaustive research, Western has failed to discover a single Arkansas case considering evidence of lost products for a *new* business after the *Marvell Light* decision. This dearth of authority supports the proposition that Arkansas courts continue to adhere firmly to *Marvell Light*.

Nor is there any reason to believe that the Arkansas courts would deviate from the *Marvel Light* decision now. The rationale supporting the Arkansas Supreme Court's ruling continues to remain as persuasive today as it did in 1924. As the Fourth Circuit explained in *Coastland Corp. v. Third National Mortgage Co.*, 611 F.2d 969 (4th Cir. 1979), the New Business Rule provides a "safegiard" against an unsubstantiated award of damages for lost profits:

> "If an established business, with an established earning capacity, is interrupted and there is no other practical way to estimate the damages thereby caused, evidence of the prior and subsequent record of the business is admissible to permit an intelligent and probable estimate of

> damages . . . But where a *new* business or enterprise is involved, the rule is not applicable for the reason that such a business is a *speculative venture*, the successful operating of which depends upon future bargains, the status of the market, and too many other contingencies to furnish a safeguard in fixing the measure of damages."

(Emphasis added). *Coastland Corp.*, 611 F.2d at 977. In fact, the New Business Rule actually serves to encourage new businesses. Fear of exposure to a damages claim arising from an inventor's own expectation of his product's potential for success would chill companies like Western from seeking to promote new products.

It is therefore not surprising that a number of courts have recently reaffirmed the New Business Rule, and refused to consider evidence of lost profits for a new business. *See, e.g. Stuart Park Associates Limited Partnership v. Ameritech Pension Trust*, 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law); *Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410, 1413-1415 (8th Cir. 1995) (Oklahoma law); *Springwill Dispensers, Inc. v. Hall China Company*, 204 Ga. App. 245, 419 S.E.2d 112 (1992) (Georgia law); *Center Ridge Ganley, Inc. v. Stinn*, 71 Ohio App. 3d 514, 594 N.E.2d 1064, 1070 (1991) (Ohio law); *International Minerals and Resources, Inc. v. Pappas*, 761 F. Supp. 1069, 1079 (S.D.N.Y. 1991) (New York law); *Murray, etc., et al. v. Hadid, et al.*, 238 Va. 722, 385 S.E.2d 898, 905 (1989) (Virginia Law); *In re Phoenix Restoration Specialists, Inc.*, 14 B.R. 115, 123-24 (Bkrptcy. Mass. 1981) (Massachusetts law)

2. *Clever Endeavor was a new venture or a new business.*

Although MindGames incorporated in March 1988, MindGames was clearly a new business in March of 1990 when it executed the License and joined forces with Western and Games Gang. Consequently, MindGames, as a "new business," is subject to the repercussions of the New Business Rule.

Blackwell asserts that he envisioned *Clever Endeavor* when he incorporated MindGames in March 1988; however, MindGames did not decide to even market *Clever Endeavor* until the spring of 1989, and it did not manufacture and distribute the first wave of *Clever Endeavor* games until September 1989. (*See,* Blackwell Dep. pp. 24, 107, 168-169). Four months after MindGames began to distribute *Clever Endeavor,* Blackwell met with representatives of Games Gang to discuss a joint venture. (*See,* Blackwell Dep. pp. 192-193). These discussions culminated in the execution of the License in March 1990. In total, MindGames marketed and sold *Clever Endeavor* itself for less than a year before it joined forces with Western and Games Gang, and it failed to achieve *any* profit during that period of time. (*See,* Exhibit B; *see also* MindGames' 1988 income statement, a copy of which is attached hereto as Exhibit G).

Under these circumstances, MindGames is clearly a "new" business as a matter of law. *See,* e.g. *McBraver v. Teckla. Inc.,* 496 F.2d 122 (5th Cir. 1974) (plaintiff not entitled to lost profits in his breach of contract claim because he was only in operation for 9 and a half months prior to the contract and failed to achieve a profit during

that time); *Delhanty, et al. v. First Pennsylvania Bank, N.A.*, 318 Pa. Super. 90, 464 A.2d 1243 (1983) (court held that plaintiff company's anticipated profits were too speculative to sustain an award of damages because plaintiff had only been in operation for seven months and had no record of profitability).

MindGames may argue that it was an "established" business at the time it executed the License, and, therefore, it is not subject to the New Business Rule. However, such an assertion would be in vain.

MindGames had barely introduced *Clever Endeavor* to the public before it executed the License and permitted Western and Games Gang to exclusively manufacture, market, sell and distribute *Clever Endeavor*. Moreover, MindGames operated *only* at a loss prior to joining forces with Western and Games Gang. (*See,* Exhibits B and G). These traits are not characteristic of an "established" business.

> "An established business should be one that is in actual operation long enough to give it permanency and recognition. It should be one that has earned a profit which can reasonably be ascertained and approximated . . . Proof of an operation of a business at a loss fails to meet this test."

McBrayer, 496 F.2d at 128, quoting *Atomic Fuel Extraction Corporation v. Slick,* 386 S.W.2d 180, 189 (Tex. Ct. Civ. App. 1964).

Additionally, Blackwell's own admissions contradict any claim that MindGames, whose sole product was

Clever Endeavor, was not a "new" business. In his September 12, 1990 letter to Games Gang, Blackwell relayed his concerns about the proposed television advertising campaign for *Clever Endeavor*. Significantly, one of the reasons he rejected the proposed commercial had to do with his classification of *Clever Endeavor* as a new product:

> "Furthermore, *new* products don't benefit from short duration commercials in the same way as older, more established products do. *New* products need longer duration commercials in order to gain the same consumer response."

(Emphasis added) (A copy of Blackwell's September 12, 1990 letter to Games Gang is attached hereto as Exhibit H). Clearly, Blackwell himself still considered *Clever Endeavor* to be a new product six months *after* the parties executed the License. Consequently, MindGames will not be able to avoid the New Business Rule's preclusive effect on its attempt to recover its alleged lost profits.

3. *The success of a new product in the entertainment industry is especially difficult to predict.*

Even if the Court were to question whether the Arkansas Supreme Court would retreat from its across the board application of the New Business Rule, there can be no doubt that such a retreat would not be warranted here. It is particularly appropriate to apply this rule in the entertainment/consumer product industry where the chances of success are next to impossible to predict because an entertainment product, such as an adult board game is subject to the most subjective and unpredictable

critic – the public. *See, Proteus Books Ltd. v. Cherry Lane Music Co,* 873 F.2d 502, 510 (2nd Cir. 1989) (affirming district court's decision to vacate jury's damages award because, *inter alia,* inherent uncertainties of predicting profits in the entertainment industry made prospective sales of book publisher difficult, if not impossible, to calculate); *Kenford Co. v. County of Erie,* 67 N.Y.2d 257, 493 N.E.2d 234, 236 (1986) (court found plaintiff's evidence of prospective profits of new stadium insufficient to support any recovery for lost profits).

Among numerous other factors, the success of a product in the entertainment industry is contingent on many subjective factors including:

- the play value or enjoyment one obtains from the product;
- the economy at the time the product is introduced to the market;
- the number of similar products in the market; and
- the cost of the product itself.

Mr. Blackwell himself has conceded that the game industry is especially susceptible to the unique tastes of the average consumer and unanticipated oscillations in the marketplace. In his October 18, 1990 letter to Greta Perry of the Gazette Newspapers in New York, Blackwell attached Ms. Perry's recent article on the game industry and praised Ms. Perry's "keen analysis" of what makes a game successful. (A copy of Blackwell's October 18, 1990 letter and the attached article by Ms. Perry is attached hereto as Exhibit I). In Ms. Perry's article, one industry commentator noted: "for every 1000 games that get

invented, five make it to the shelf and maybe one of two get a *second* year." (Emphasis added) (*See,* Exhibit I). Later, in his application to Harvard Business School in 1994, Blackwell himself acknowledged the difficulty of marketing a successful game in the entertainment industry when he admitted that:

> "[building a successful game company and licensing their first product] is a popular and powerful dream, but unfortunately, too few actually succeed. When one recalls the more publicized failures of product introductions by established corporations, I [Blackwell] believe [MindGames'] accomplishment becomes more substantial. The experience proved my [Blackwell's] business and leadership skills in a hostile and unforgiving market." (*See,* p. 7 of Mr. Blackwell's application to Harvard Business School, a copy of which is attached hereto as Exhibit J.)

Despite these long odds, Blackwell thought that *Clever Endeavor* would be the "next *Trivial Pursuit* or *Pictionary,*" (*See,* Exhibit F), and he was apparently disappointed that *Clever Endeavor* fell short of his lofty expectations.[2] However, *Clever Endeavor*'s limited success can be

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[2] Mr. Blackwell's credibility on the issue of *Clever Endeavor*'s purported lack of success is questionable at best. Contrary to the allegations in MindGames' complaint, Mr. Blackwell repeatedly touted the "success" of Clever Endeavor. For example, in his applications to Harvard and Stanford business schools, Blackwell claims that *Clever Endeavor* was the "most successful, independently published game in the [adult game] industry for the four years following its introduction" and the "most successful game introduced by an independent game publisher in the past five years." (*see,* Exhibit J at p. 7; *see also* Mr. Blackwell's application to Stanford Business School, a

attributed to many factors independent of the alleged manufacturing or advertising problems, including the following potential causes:

1. *Clever Endeavor* was one of the more expensive adult games in the market (Blackwell Dep. p. 98);

2. There were other similar adult board games on the market, including *Anybody's Guess*, which were similar to *Clever Endeavor* (Blackwell Dep. pp. 423-433);

3. Despite Western's advice, Blackwell rejected television advertising in favor of radio advertising (Blackwell Dep. pp. 361, 369-370, 378, 386-392; *see also* Blackwell's September 12, 1990 letter to Dave Gillies at Games Gang regarding the effectiveness of radio advertising, a copy of which was previously attached hereto as Exhibit H);

4. *Clever Endeavor*'s first full year in the marketplace, 1990, was a "rotten" year for the game industry as a whole (*See*, Blackwell's January 9, 1991 letter to Mary Mellor at Games Gang, a copy of which is attached hereto as Exhibit N); and

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copy of which is attached hereto as Exhibit K, and Mr. Blackwell's June 6, 1994 letter to the Harvard Business School, a copy of which is attached hereto as Exhibit L.) Moreover, in his September 7, 1990 letter to Games Gang, Blackwell states: "Thanks for your terrific support. You're the reason for *Clever Endeavor's success.*" (Emphasis added) (A copy of the September 7, 1990 letter is attached hereto as Exhibit M.)

5. The play value of the game itself, which may not have appealed to consumers to the degree Mr. Blackwell hoped.

The aforementioned facts are just a few of the many reasons that *Clever Endeavor* did not become the next *Trivial Pursuit* or *Pictionary*. It is the nature of the entertainment industry itself, as well as common sense, which necessarily dictate that one cannot point to a single factor which caused *Clever Endeavor* to fail to achieve the success MindGames now claims it expected.

The Eight Circuit Court's opinion in *Hillside Enterprises* illustrates the rationale and application of the New Business Rule in the entertainment/consumer product industry. In *Hillside Enterprises*, a wine marketer ("Hillside") sued a disposable wine manufacturer ("Carlisle") for breach of contract after the manufacturer failed to properly manufacture and ship the required number of Hillside's new product – disposable plastic wine glasses with fliptop lids Hillside alleged that it could not fill its first, and only, large order for 30,000 glasses, and that its "wine-in-a-glass" venture lost substantial profits and ceased operations as a result of Carlisle's failure to adequately manufacture the new product.

At trial, Hillside attempted to introduce evidence of its future sales from wine glasses which had not yet been ordered. The district court, however, refused to admit this evidence because it was too speculative, and Hillside appealed. On appeal, the Eight Circuit court affirmed the district court's ruling, and expressly noted that lost profits are highly speculative and are generally not allowed as damages where a new business or product are at issue. *Hillside Enterprises*, 69 F.3d at 1414. Moreover, the

court found that Hillside's product could have failed for reasons independent of the problems with the glasses, such as the cost of the product or consumers' failure to find the convenience of packaged wine more important than the price and quality of the wine. *Id.* For these reasons, the appellate court upheld the district court's decision to *only* allow evidence of lost profits from Hillside's one confirmed order for 30,000 glasses, which Hillside was unable to fulfill because of Carlisle's breach. *Id.*

Unlike the plaintiff in *Hillside Enterprises,* MindGames does not even allege that it lost profits as a result of Western's failure to fulfill a specific sales order or that Western otherwise failed to pay MindGames its royalties for *Clever Endeavor* games previously sold by Western. Rather, MindGames only seeks profits from the uncertain or future sales of *Clever Endeavor* which it allegedly lost due to Western's breach of the License. Without being able to determine the "cause," MindGames cannot possibly be able to demonstrate the "effect" (*i.e.,* lost profits) with any reasonable certainty. Consequently, this court should strictly apply the New Business Rule, as the Supreme Court of Arkansas did in *Marvell Light & Ice Co.,* and prohibit MindGames' recovery of all its alleged lost profits as a matter of law.[3]

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[3] As a result of the unpredictable nature of the entertainment industry, it is not surprising that other parties similarly situated to MindGames have also been unable to recover the alleged lost profits of their new businesses. *See, e.g., Proteus Books Ltd. v. Cherry Lane Music Co., supra; National Controls v. National Semiconductor,* 833 F.2d 491 (3rd Cir. 1987) (buyer of microprocessor units failed to sustain burden of proving under Pennsylvania law that seller's breaches were

4. MindGames has no history of past profits.

Even if the court were to reject a strict application of the New Business Rule, this court should still grant Western's motion for partial summary judgment because MindGames has no history of past profits.

In addition to the inherent difficulties of predicting the success of a new entertainment product, MindGames faces the additional burden of demonstrating its alleged lost profits without any prior history of profitability. It is undisputed that MindGames will not be able to introduce evidence of its profits prior to the alleged breach of the License committed by Western because MindGames failed to achieve *any* profit in 1988 or 1989. (*See,* Exhibits B and G). Without any evidence of past profits, anticipated profits often cannot be recovered regardless of whether the damaged party was a new business. *See, Rich v. Eastman Kodak Company,* 583 F.2d 435, 437 (8th Cir. 1978) (plaintiff company unable to recover its anticipated profits because it was not making a profit before problems developed with the product); *Empire Shoe Company v.*

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proximate cause of buyer's alleged loss of profits on sale of telephones to third party, and, therefore, buyer not entitled to damages for lost profits); *Handi Caddy, Inc. v. American Home Products Corp.,* 557 F.2d 136 (8th Cir. 1977) (8th Circuit Court reduced jury's damages award for lost profits because evidence in action to recover for breach of contract to advertise new product on pizza packages failed to support recovery of lost profits awarded by jury.); *Murray, etc. et. al v. Hadid, et. al., supra* (affirming trial court's decision to set aside jury's award of lost profits because evidence of new enterprise's lost profits depended upon too many contingencies to safeguard an estimate of damages); *Kenford Co., Inc. v. County of Erie, supra.*

Nico Industries, Inc., 197 Ga. App. 411, 414, 398 S.E.2d 440, 443 (1990) (granting defendant summary judgment on the issue of lost profits because plaintiff could not produce any evidence regarding past net profits); *see also Keener v. Sizzler Family Steak Houses*, 597 F.2d 453, 459 (5th Cir. 1979). Consequently, without such evidence of past profits, MindGames will lack a reliable basis to demonstrate its alleged lost profits with any reasonable certainty.

V. CONCLUSION

For all the aforementioned reason, Western respectfully requests that this Court grant its motion for partial summary judgment and find that MindGames cannot recover its alleged lost profits as a matter of law.

Dated: May 17, 1996

/s/ Richard Saldinger
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United States Court of Appeals
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT – WITH ORAL ARGUMENT

Date: June 22, 2000

BEFORE: Honorable RICHARD A. POSNER,
Chief Judge
Honorable THOMAS E. FAIRCHILD,
Circuit Judge
Honorable DIANE P. WOOD, Circuit Judge

No. 98-1879

WESTERN PUBLISHING COMPANY, INCORPORATED,
Plaintiff-Appellee

v.

MINDGAMES, INCORPORATED,
Defendant-Appellant

Appeal from the United States District Court
for the Eastern District of Wisconsin
No. 94 C 552, Lynn Adelman, Judge

The judgment of the District Court is AFFIRMED, with costs, in accordance with the decision of this court entered on this date.

(1061-110393)

In the
United States Court of Appeals
for the Seventh Circuit

No. 98-1879
MINDGAMES, INC.,

Plaintiff-Appellant,

v.

WESTERN PUBLISHING COMPANY, INC.,

Defendant-Appellee.

Appeal from the United States District Court
for the Eastern District of Wisconsin.
Nos. 94-C-552, 94-C-998 – Lynn S. Adelman, *Judge.*

ARGUED APRIL 17, 2000 – DECIDED JUNE 22, 2000

Before POSNER, *Chief Judge,* and FAIRCHILD and DIANE P. WOOD, *Circuit Judges.*

POSNER, *Chief Judge.* This is a diversity suit for breach of contract, governed by Arkansas law because of a choice of law provision in the contract. The plaintiff, MindGames, was formed in March of 1988 by Larry Blackwell to manufacture and sell an adult board game, "Clever Endeavor," that he had invented. The first games were shipped in the fall of 1989 and by the end of the year, 75 days later, 30,000 had been sold. In March of 1990, MindGames licensed the game to the defendant,

Western, a major marketer of games. Western had marketed the very successful adult board games "Trivial Pursuit" and "Pictionary" and thought "Clever Endeavor" might be as successful. The license contract, on which this suit is premised, required Western to pay MindGames a 15 percent royalty on all games sold. The contract was by its terms to remain in effect until the end of January of 1993, or for another year if before then Western paid MindGames at least $1.5 million in the form of royalties due under the contract or otherwise, and for subsequent years as well if Western paid an annual renewal fee of $300,000.

During the first year of the contract, Western sold 165,000 copies of "Clever Endeavor" and paid MindGames $600,000 in royalties. After that, sales fell precipitously (though we're not told by how much) but the parties continued under the contract through January 31, 1994, though Western did not pay the $900,000 ($1.5 million minus $600,000) that the contract would have required it to pay in order to be entitled to extend the contract for a year after its expiration. In February of 1994 the parties finally parted. Later that year MindGames brought this suit, which seeks $900,000, plus lost royalties of some $40 million that MindGames claims it would have earned had not Western failed to carry out the promotional obligations that the contract imposed on it, plus $300,000 on the theory that Western renewed the contract for a third year, beginning in February of 1994; Western sold off its remaining inventory of "Clever Endeavor" in that year.

The district court granted summary judgment for Western, holding that the contract did not entitle

MindGames to a renewal fee and that Arkansas's "new business" rule barred any recovery of lost profits. 944 F.Supp. 754 (E.D.Wis.1996); 995 F.Supp. 949 (E.D.Wis.1998). Although the victim of a breach of contract is entitled to nominal damages, *Mason v. Russenberger*, 542 S.W.2d 745 (Ark. 1976); *Movitz v. First Nat. Bank of Chicago*, 148 F.3d 760, 765 (7th Cir. 1998); E. Allan Farnsworth, Contracts § 12.8, p. 784 (3d ed.1999), MindGames does not seek them; and so if it is not entitled to either type of substantial damages that it seeks, judgment was correctly entered for Western. By not seeking nominal damages, incidentally, MindGames may have lost a chance to obtain significant attorneys' fees, to which Arkansas law entitles a prevailing party in a breach of contract case. See *Dawson v. Temps Plus, Inc.*, 987 S.W.2d 722, 729 (Ark. 1999).

The rejection of MindGames' claim to the renewal fee for the second year (and *a fortiori* the third) was clearly correct. The contract conditioned Western's right to renew the contract for a second year on its paying a renewal fee of $1.5 million (minus royalties already paid); it was silent on the terms of a renewal adopted by a new agreement of the parties rather than by the exercise of an option granted by the original contract. If MindGames hadn't wanted to renew the contract and Western had insisted, then Western would have had to pay the fee. But if Western did not invoke a contractual right to renew, if instead the parties entered into a new agreement to renew the contract, then MindGames had no right to the renewal fee fixed in the contract; that right was *conditional* on Western's exercising its contractual right to renew. A conditional right in a contract does not become

an enforceable right until the condition occurs, *Restatement (Second) of Contracts* § 225(1) (1981), unless noncompliance with the condition is excused by agreement, *Uebe v. Bowman*, 420 S.W.2d 889 (Ark. 1967); *Normand v. Orkin Exterminating Co.*, 193 F.3d 908, 912 (7th Cir. 1999), or by operation of law, *Farnsworth, supra* § 8.3, p. 526, as where the other party to the contract wrongfully prevents the condition from occurring, *id.*, § 8.6, pp. 544-45; *Restatement, supra*, § 225, comment b, which is not alleged, for Western had no duty to exercise its right of renewal. The condition that would have entitled MindGames to demand a renewal fee thus did not occur here; Western did not invoke its contractual right to extend the contract; after January 31, 1993, the parties were operating under a new contract.

The more difficult issue is MindGames' right to recover lost profits for Western's alleged breach of its duty to promote "Clever Endeavor." A minority of states have or purport to have a rule barring a new business, as distinct from an established one, from obtaining damages for lost profits as a result of a tort or a breach of contract. E.g., *Lockheed Information Management Systems Co. v. Maximus, Inc.*, 524 S.E.2d 420, 429-30 (Va. 2000); *Bell Atlantic Network Services, Inc. v. P.M. Video Corp.*, 730 A.2d 406, 419-20 (N.J. Super. 1999); *Interstate Development Services of Lake Park, Georgia, Inc. v. Patel*, 463 S.E.2d 516 (Ga. App. 1995); *Stuart Park Associates Limited Partnership v. Ameritech Pension Trust*, 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law); Bernadette J. Bollas, Note, "The New Business Rule and the Denial of Lost Profits," *48 Ohio St. L.J.* 855, 859 & n. 32 (1987). The rule of *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854), often prevents the victim of

a breach of contract from obtaining lost profits, but that rule is not invoked here. Neither the "new business" rule nor the rule of *Hadley v. Baxendale* stands for the *general* proposition that lost profits are never a recoverable item of damages in a tort or breach of contract case.

Arkansas is said to be one of the "new business" rule states on the strength of a case decided by the state's supreme court many years ago. The appellants in *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924), sought to recover the profits that they claimed to have lost as a result of a five and a half month delay in the delivery of icemaking machinery; the delay, the appellants claimed, had forced them to delay putting their ice factory into operation. The court concluded, however, that because there was no indication "that the manufacture and sale of ice by appellants was an established business so that proof of the amount lost on account of the delay . . . might be made with reasonable certainty," "the anticipated profits of the new business are too remote, speculative, and uncertain to support a judgment for their loss." It quoted an earlier decision in which another court had said that "he who is prevented from embarking in [sic – must mean 'on'] a new business can recover no profits, because there are no provable data of past business from which the fact that anticipated profits would have been realized can be legally deduced." *Central Coal & Coke Co. v. Hartman*, 111 Fed. 96, 99 (8th Cir. 1901). That quotation is taken to have made Arkansas a "new business" state, although the rest of the *Marvell* opinion indicates that the court was concerned that the anticipated profits of the *particular* new business at issue, rather than of every new business, were too

speculative to support an award of damages. On its facts, moreover, *Marvell* was a classic *Hadley v. Baxendale* type of case – in fact virtually a rerun of *Hadley*, except that the appellants alleged that they had notified the seller of the icemaking machinery of the damages that they would suffer if delivery was delayed, and the seller had agreed to be liable for those damages. The decision is puzzling in light of that allegation; it is doubly puzzling because, assuming that by the time of the trial the ice factory was up and running, it should not have been difficult to compute the damages that the appellants had lost by virtue of the five and a half month delay in placing the factory in operation. Presumably it would have had five and a half months of additional profits.

Marvell has never been overruled; and federal courts ordinarily take a nonoverruled decision of the highest court of the state whose law governs a controversy by virtue of the applicable choice of law rule to be conclusive on the law of the state. E.g., *Milwaukee Metropolitan Sewerage District v. Fidelity & Deposit Co.*, 56 F.3d 821, 823 (7th Cir. 1995); *C & B Sales & Service, Inc. v. McDonald*, 111 F.3d 27, 29 n. 1 (5th Cir. 1997); *New York Life Ins. Co. v. K N Energy, Inc.*, 80 F.3d 405, 409 (10th Cir. 1996). But this is a matter of practice or presumption, not of rule. The rule is that in a case in federal court in which state law provides the rule of decision, the federal court must predict how the state's highest court would decide the case, and decide it the same way. *Treco, Inc. v. Land of Lincoln Savings & Loan*, 749 F.2d 374, 377 (7th Cir. 1984); *New Hampshire Ins. Co. v. Vieira*, 930 F.2d 696, 701 (9th Cir. 1991); 19 Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice and Procedure* § 4507,

pp. 126-50 (2d ed.1996). Law, Holmes said, in a controversial definition that is, however, a pretty good summary of how courts apply the law of other jurisdictions, is just a prediction of what the courts of that jurisdiction would do with the case if they got their hands on it. Oliver Wendell Holmes, "The Path of the Law," 10 *Harv. L.Rev.* 457, 461 (1897). Since state courts like federal courts do occasionally overrule their decisions, there will be occasional, though rare, instances in which the best prediction of what the state's highest court will do is that it will *not* follow its previous decision. See, e.g., *Burgess v. Lowery*, 201 F.3d 942, 948 (7th Cir. 2000); *Treco, Inc. v. Land of Lincoln Savings & Loan*, *supra*, 749 F.2d at 377; *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1176 (3d Cir. 1993); 19 Wright, Miller & Cooper, *supra*, § 4507, pp. 141-49.

That is the best prediction in this case. *Marvell* was decided more than three quarters of a century ago, and the "new business" rule which it has been thought to have announced has not been mentioned in a published Arkansas case since. The opinion doesn't make a lot of sense on its facts, as we have seen, and the Eighth Circuit case on which it relied has long been superseded in that circuit. See, e.g., *Central Telecommunications, Inc. v. TCI Cablevision, Inc.*, 800 F.2d 711, 727-28 (8th Cir. 1986). The Arkansas cases decided since *Marvell* that deal with damages issues exhibit a liberal approach to the estimation of damages that is inconsistent with a flat rule denying damages for lost profits to all businesses that are not well established. *Jim Halsey Co. v. Bonar*, 683 S.W.2d 898, 902-03 (Ark. 1985); *Tremco, Inc. v. Valley Aluminum Products Corp.*, 831 S.W.2d 156, 158 (Ark. App. 1992); *Ozark Gas Transmission Systems v. Barclay*, 662 S.W.2d 188, 192 (Ark. App.

1983); J.W. Looney, "The 'New Business Rule' and Breach of Contract Claims for Lost Profits: Playing MindGames with Arkansas Law," 1997 *Ark. L. Notes* 43, 46-47. The *Ozark* decision, for example, allowed an orchard farmer to recover for the damages to a *new* orchard. The "new business" rule has, moreover, been abandoned in most states that once followed it, e.g., *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin*, 717 A.2d 724, 733-35 (Conn. 1998); *AGF, Inc. v. Great Lakes Heat Treating Co.*, 555 N.E.2d 634, 637-39 (Ohio 1990); *No Ka Oi Corp. v. National 60 Minute Tune, Inc.*, 863 P.2d 79, 81-82 (Wash. App. 1993); *Orchid Software, Inc. v. Prentice-Hall, Inc.*, 804 S.W.2d 208, 210-11 (Tex.App.1991); *Beck v. Clarkson*, 387 S.E.2d 681, 683-84 (S.C.App.1989); see also *McNamara v. Wilmington Mall Realty Corp*, 466 S.E.2d 324, 330 (N.C.App.1996); *International Telepassport Corp. v. USFI, Inc.*, 89 F.3d 82, 85-86 (2d Cir. 1996) (per curiam) (New York law); *Restatement, supra*, § 352, comment b, and it seems to retain little vitality even in states like Virginia, which purport to employ the hard-core per se approach. See *Commercial Business Systems, Inc. v. Bellsouth Services, Inc.*, 453 S.E.2d 261, 268-69 (Va. 1995); see generally *Eljer Mfg., Inc. v. Kowin Development Corp.*, 14 F.3d 1250, 1256 (7th Cir. 1994).

Western tries to distinguish *Ozark* by pointing to the fact that the plaintiff there was an established orchard farmer, albeit the particular orchard represented a new venture for him. This effort to distinguish that case brings into view the primary objection to the "new business" rule, an objection of such force as to explain its decline and make it unlikely that Arkansas would follow it if the

occasion for its supreme court to choose arose. The objection has to do with the difference between *rule* and *standard* as methods of legal governance. A rule singles out one or a few facts and makes it or them conclusive of legal liability; a standard permits consideration of all or at least most facts that are relevant to the standard's rationale. A speed limit is a rule; negligence is a standard. Rules have the advantage of being definite and of limiting factual inquiry but the disadvantage of being inflexible, even arbitrary, and thus overinclusive, or of being underinclusive and thus opening up loopholes (or of being *both* over- and underinclusive!). Standards are flexible, but vague and open-ended; they make business planning difficult, invite the sometimes unpredictable exercise of judicial discretion, and are more costly to adjudicate – and yet when based on lay intuition they may actually be more intelligible, and thus in a sense clearer and more precise, to the persons whose behavior they seek to guide than rules would be. No sensible person supposes that rules are always superior to standards, or vice versa, though some judges are drawn to the definiteness of rules and others to the flexibility of standards. But that is psychology; the important point is that some activities are better governed by rules, others by standards. States that have rejected the "new business" rule are content to control the award of damages for lost profits by means of a standard – damages may not be awarded on the basis of wild conjecture, they must be proved to a reasonable certainty, e.g., *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin*, *supra*, 717 A.2d at 733-34; *AGF, Inc. v. Great Lakes Heat Treating Co.*, *supra*, 555 N.E.2d at 638-39 – that is applicable to proof of

damages generally. See, e.g., *Jones Motor Co. v. Holtkamp, Liese, Beckemeier & Childress, P.C.*, 197 F.3d 1190, 1194-95 (7th Cir. 1999), and cases cited there; *Ashland Management Inc. v. Janien*, 624 N.E.2d 1007, 1010 (N.Y.1993); *Restatement, supra*, § 352. The "new business" rule is an attempt now widely regarded as failed to control the award of such damages by means of a rule.

The rule doesn't work because it manages to be at once vague and arbitrary. One reason is that the facts that it makes determinative, "new," "business," and "profits," are not facts, but rather are the conclusions of a reasoning process that is based on the rationale for the rule and that as a result turns the rule into an implicit standard. What, for example, is a "new" business? What, for that matter, is a "business"? And are royalties what the rule means by "profits"? MindGames was formed more than a year before it signed the license agreement with Western, and it sold 30,000 games in the six months between the first sales and the signing of the contract. MindGames' only "business," moreover, was the licensing of intellectual property. An author who signs a contract with a publisher for the publication of his book would not ordinarily be regarded as being engaged in a "business," or his royalties or advance described as "profits." He would be surprised to learn that if he sued for unpaid royalties he could not get them because his was a "new business." Suppose a first-time author sued a publisher for an accounting, and the only issue was how many copies the publisher had sold. Under the "new business" rule as construed by Western, the author could not recover his lost royalties even though there was no uncertainty about what he had lost. So construed and applied, the rule

would have no relation to its rationale, which is to prevent the award of speculative damages.

Western goes even further, arguing that even if it, Western, a well-established firm, were the plaintiff, it could not recover its lost profits because the sale of "Clever Endeavor" was a new business. On this construal of the rule, "business" does not mean the enterprise; it means any business activity. So Western's sale of a new game is a new business, yet we know from the *Ozark* decision that an orchard farmer's operation of a new orchard is an old business.

The rule could be made sensible by appropriate definition of its terms, but we find it hard to see what would be gained, given the existence of the serviceable and familiar standard of excessive speculativeness. The rule may have made sense at one time; the reduction in decision costs and uncertainty brought about by avoiding a speculative mire may have swamped the increased social costs resulting from the systematically inadequate damages that a "new business" rule decrees. But today the courts have become sufficiently sophisticated in analyzing lost-earnings claims, and have accumulated sufficient precedent on the standard of undue speculativeness in damages awards, to make the balance of costs and benefits tip against the rule. In any event we are far in this case, in logic as well as time, from the ice factory whose opening was delayed by the General Electric Company. We greatly doubt that there is a "new business" rule in the common law of Arkansas today, but if there is it surely does not extend so far beyond the facts of the only case in which the rule was ever invoked to justify its

invocation here. There is no authority for, and no common sense appeal to, such an extension.

But that leaves us with the question of undue speculation in estimating damages. Abrogation of the "new business" rule does not produce a free-for-all. What makes MindGames' claim of lost royalties indeed dubious is not any "new business" rule but the fact that the success of a board game, like that of a book or movie, is so uncertain. Here newness enters into judicial consideration of the damages claim not as a rule but as a factor in applying the standard. Just as a start-up company should not be permitted to obtain pie-in-the-sky damages upon allegations that it was snuffed out before it could begin to operate (unlike the ice factory in *Marvell*, which did begin production, albeit a little later than planned), capitalizing fantasized earnings into a huge present value sought as damages, so a novice writer should not be permitted to obtain damages from his publisher on the premise that but for the latter's laxity he would have had a bestseller, when only a tiny fraction of new books achieve that success. Damages must be proved, and not just dreamed, though "some degree of speculation is permissible in computing damages, because reasonable doubts as to remedy ought to be resolved against the wrongdoer." *Jones Motor Co. v. Holtkamp, Liese, Beckemeier & Childress, P.C., supra*, 197 F.3d at 1194; see *Restatement, supra*, § 352, comment a.

This is not to suggest that damages for lost earnings on intellectual property can never be recovered; that "entertainment damages" are not recoverable in breach of contract cases. That would just be a variant of the discredited "new business" rule. What is important is that

Blackwell had no track record when he created "Clever Endeavor." He could not point to other games that he had invented and that had sold well. He was not in the position of the bestselling author who can prove from his past success that his new book, which the defendant failed to promote, would have been likely – not certain, of course – to have enjoyed a success comparable to that of the average of his previous books if only it had been promoted as promised. That would be like a case of a new business launched by an entrepreneur with a proven track record.

In the precontract sales period and the first year of the contract a total of 195,000 copies of "Clever Endeavor" were sold; then sales fizzled. The public is fickle. It is possible that if Western had marketed the game more vigorously, more would have been sold, but an equally if not more plausible possibility is that the reason that Western didn't market the game more vigorously was that it correctly sensed that demand had dried up.

Even if that alternative is rejected, we do not see how the number of copies that would have been sold but for the alleged breach could be determined given the evidence presented in the summary judgment proceedings (a potentially important qualification, of course); and so MindGames' proof of damages is indeed excessively speculative. See, e.g., *Gentry v. Little Rock Road Machinery Co.*, 339 S.W.2d 101, 104 (Ark. 1960); *Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410, 1414 (8th Cir. 1995); *K & R, Inc. v. Crete Storage Corp.*, 231 N.W.2d 110, 115 (Neb. 1975); see also *AGF, Inc. v. Great Lakes Heat Treating Co.*,

supra, 555 N.E.2d at 640. Those proceedings were completed with no evidence having been presented from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter some broad but bounded range of alternative estimates, of copies of "Clever Endeavor" would have been sold had Western honored the contract. MindGames obtained $600,000 in royalties on sales of 165,000 copies of the game, implying that Western would have had to sell more than 10 million copies to generate the $40 million in lost royalties that MindGames seeks to recover. Cf. *Boxhorn's Big Muskego Gun Club, Inc. v. Electrical Workers Local 494*, 798 F.2d 1016, 1023 (7th Cir. 1986).

When the breach occurred, MindGames should have terminated the contract and sought distribution by other means. See *Farnsworth, supra*, § 12.12, pp. 806-08. The fact that it did not do so – that so far as appears it has made no effort to market "Clever Endeavor" since the market for the game collapsed in 1991 – is telling evidence of a lack of commercial promise unrelated to Western's conduct.

Although Western in its brief in this court spent most of its time misguidedly defending the "new business" rule, clinging to *Marvell* for dear life (a case seemingly on point, however vulnerable, is a security blanket that no lawyer feels comfortable without), it did argue that in any event MindGames' claim for lost royalties was too speculative to ground an award of damages for that loss. The argument was brief but not so brief as to fail to put MindGames on notice of a possible alternative ground for upholding the district court's judgment; we may of course affirm an award of summary judgment on any

ground that has not been forfeited or waived in the district court. *United States v. Jackson*, 207 F.3d 910, 917 (7th Cir. 2000). MindGames did not respond to the argument in its reply brief. It pointed to no evidence from which lost royalties could be calculated to even a rough approximation. We find its silence eloquent and Western's argument compelling, and so the judgment in favor of Western is

AFFIRMED.

FAIRCHILD, *Circuit Judge*, dissenting in part.

I agree that (1) MindGames' claim for a renewal fee for the year following the initial term of the Licensing Agreement was properly dismissed, and (2) we are not bound by *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924) to affirm the dismissal of MindGames' claim for loss of royalties caused by breach of contract. I do, however, respectfully disagree with the conclusion that, as a matter of law, that claim is too speculative to support an award of damages.

This was never a claim in which MindGames sought to recover lost profits from the operation of a business. The damages sought would be measured by the royalties which Western would have been obliged to pay on sales which did not occur because of Western's alleged failure to perform its contract. Western's obligation to pay royalties arose from the sales of games manufactured, promoted and sold by it, and whether MindGames showed a profit, as well as MindGames' lack of history, was wholly

irrelevant. The ultimate questions would be whether there was a breach by Western and whether the breach caused a loss of sales.

Sales did not meet expectations. In the period from March 30, 1990 to January 31, 1991, 165,000 games were sold; in the year ending January 31, 1992, 58,113; in the year ending January 31, 1993, 26,394; and in the year after the initial term, 7,438. The sales in the initial term totaled approximately $4,000,000 and royalties $600,000. Soon after January 31, 1993, Western was sufficiently interested in continuing as licensee to agree to pay a minimum royalty of $27,500 for the coming year. MindGames' complaint alleged that a substantial number of games produced by Western failed to meet quality standards; Western failed to promote and make reasonable efforts to sell; and its efforts did not meet standards under the agreement or those recognized in the industry. It is MindGames' position that these failures caused loss of sales.

Western's motion for partial summary judgment was premised on the new business rule which Western perceived as announced in *Marvell*, and the district court granted the motion on that basis. If, as we all agree, *Marvell* does not control this case, then the applicable Arkansas doctrine is that MindGames is entitled to recover any royalties on sales which MindGames can prove to a reasonable certainty would have been made had Western carried out the contract. The rule that damages which are uncertain cannot be recovered does not apply to uncertainty as to the value of the benefits to be derived, but to uncertainty as to whether any benefit would be derived at all. *Jim Halsey Co., Inc. v. Bonar*, 284

Ark. 461, 467-68 (Ark. 1985); *Crow v. Russell*, 226 Ark. 121, 123 (Ark. 1956).

In my opinion we cannot say on this record, as a matter of law, that MindGames can not [sic] prove to a reasonable certainty that Western's failures to perform, if proved, caused a loss of sales.

I would not hold that MindGames has waived or forfeited its opportunity to produce evidence of damages. It is true that in responding to Western's motion for partial summary judgment MindGames did not provide evidentiary material tending to show the breaches by Western nor that such breaches caused a loss of sales. This should not be deemed a waiver or forfeiture of an opportunity to do so because of Western's complete reliance in its motion on the new business rule and *Marvell*, which, if applied, would prevent proof of breach and causation of loss. Western's motion did not reach the issue of breach, and establishing damages would require MindGames to prove that the breach occurred and caused loss of sales. Although Western, in its memorandum in support of its motion did include a section making the point that the success of a new product in the entertainment industry is especially difficult to predict, it used that point to support an argument that the new business rule was particularly appropriate in this case, and that the Arkansas Supreme Court would be unlikely to retreat from the new business rule under circumstances like these. Western did not squarely assert, as an alternative ground, that MindGames could not prove to a reasonable certainty that any breach by Western caused loss of sales. Rather, Western urged that the district court should strictly apply the new business rule.

In this court, Western again relied on *Marvell* and the new business rule, also arguing, as it had in the district court, that this type of case, involving a new product in the entertainment industry, is not one where the Arkansas Supreme Court would retreat from its application of the new business rule. Although at pages 30-32 of its brief it asserted the inherently speculative nature of a claim for lost profits in the entertainment industry, and cited cases, it failed squarely to assert, as an alternative ground, that its alleged failures to perform, if proved, could not have been proved to a reasonable certainty to have caused lost sales. On page 5 of its reply brief, MindGames referred to pages 29-32 of Western's brief, and challenged as contrary to Arkansas law "non-Arkansas cases [cited by Western] in arguing that businesses in the entertainment industry are barred per se from claiming lost profits." Again I do not think it is appropriate to rely on waiver or forfeiture.

I would remand for further proceedings on this part of MindGames' complaint.

A true Copy:

Teste:

Clerk of the United States
Court of Appeals for the
Seventh Circuit

R. App. 40

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Appeal No. 98-1879

WESTERN PUBLISHING COMPANY, INC.,

Plaintiff-Appellee-Respondent,

v. No. 94-C-552

MINDGAMES, INC.,

Defendant-Appellant-Petitioner

MINDGAMES, INC.,

Plaintiff-Appellant-Petitioner,

v. No. 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant-Appellee-Respondent.

Appeal from the United States District Court
for the Eastern District of Wisconsin,
The Honorable Robert W. Warren, followed by
The Honorable Lynn S. Adelman, Presiding

PETITION FOR REHEARING AND REHEARING *EN BANC* AND SUPPORTING APPENDIX

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Appeal No. 98-1879

CORPORATE DISCLOSURE STATEMENT

Short Caption: MindGames, Inc.
v. Western Publishing Co., Inc.

The undersigned, counsel of record for the appellant, MindGames, Inc., furnishes the following information in compliance with Fed. R. App. P. 26.1.

1. The full name of the appellant: MindGames, Inc.

2. Parent Corporation: None

3. Subsidiaries and Affiliates: None

4. The names of all law firms appearing for the appelant in this action:

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Dated: July 6, 2000

/s/ E. Campion Kersten
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PETITIONS

MindGames, Inc., petitions for rehearing pursuant to Fed.R.App.P. 40 because the panel misapprehended the record below and overlooked the failure of Western Publishing Company, Inc., to raise below the issue on which the panel relied when it affirmed the district court's grant of summary judgment.

Alternatively, MindGames petitions for rehearing *en banc* pursuant to Fed.R.App.P. 35 because the panel decision conflicts with this court's decision in *Box v. A & P Tea Co.*, 772 F.2d 1372 (7th Cir. 1985), and its progeny, and the Supreme Court's decision in *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986), and its progeny, and consideration by the full court is necessary to secure and maintain uniformity of the court's decisions.

These petitions address two aspects of the panel decision: first, affirmance of the district court on a ground not raised in or considered by that court (that, on the record presented, the lost future sales claimed by MindGames are too speculative); second, that MindGames cannot recover attorney fees allowed by Arkansas law in breach of contract cases even when damages are limited to nominal damages because it did not expressly seek "nominal" damages.

ARGUMENT

1. The Majority Misapprehended the District Court Record When it Assumed Western Argued MindGames Would Be Unable to Reasonably Estimate Sales of *Clever Endeavor* Lost Due to Western's Breach.

The panel unanimously held the New Business Rule, if still valid in Arkansas, would not apply to MindGames' claims for lost royalties, rejecting Western's invitation to follow *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924). Slip Op. at 10; Dissent, Slip Op. at 13.

Having rejected Western's only attack on MindGames' claim for lost royalties, the majority nevertheless affirmed dismissal of the claim on a ground not within either party's statement of issues here and never raised or considered below: namely, that MindGames failed to prove how many copies of *Clever Endeavor* Western would have sold (on which MindGames, as licensor, would earn royalties), absent breach.

> [W]e do not see how the number of copies that would have been sold but for the alleged breach could be determined given the evidence presented in the summary judgment proceedings (a potentially important qualification, of course); and so MindGames' proof of damages is indeed excessively speculative. Those proceedings were completed with no evidence having been presented from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter some broad but bounded range of alternative estimates, of copies of

> "Clever Endeavor" would have been sold had Western honored the contract.

Slip Op. at 12 (emphasis in original; citations omitted). This assumes Western raised below the issue whether MindGames had evidence from which a jury could reasonably estimate the quantity of games that would have been sold had Western performed.

That assumption fundamentally misapprehends the proceedings below. Western never argued uncertainty of lost sales before the district court. Consequently, MindGames was never called on to file evidence from which a jury could reasonably determine sales *Clever Endeavor* would likely have achieved had Western performed.

Western's sole attack on MindGames' claim for lost royalties was the New Business Rule. The district court saw that as the only issue before it: "Western claims that the 'New Business Rule,' which prevents new and unestablished business ventures from collecting lost profits as damages in breach of contract or tort cases, guides this case as a matter of law, and mandates partial summary judgment in Western's favor." *Western Publishing Co., Inc. v. MindGames, Inc.*, 944 F. Supp. 754, 755 (E.D. Wis. 1996).

Western's summary judgment brief below contained a single substantive argument: "The 'New Business Rule' Prevents MindGames From Recovering Any Lost Profits." P.App. at 7.[1] Its proposed findings of fact, *required* by

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[1] Western's Memorandum in Support of Its Motion for Partial Summary Judgment, without exhibits, Dist. Ct. Docket No. 48, is submitted here as Petitioner's Appendix ("P.App.")

Local Rule § 6.05(a)(1), did not address whether lost future sales were reasonably provable. Western's only proposed findings related to *Clever Endeavor* sales were ¶ 9 (sales in the year before the license) and ¶ 16 (sales during the four years of the license), P.App. at 4, 6, showing *Clever Endeavor* sales jumped from 30,000 in 1989 (the last pre-contract year) to 165,000 in 1990 (the first contract year), reasonably implying that sales were trending up prior to Western's breach. If Western had argued that lost future sales could not be proved beyond speculation, it then had the burden to propose "undisputed" facts rebutting that inference.

The record made by MindGames below did include evidence of specific contract breaches by Western from which damages could readily be inferred, as well as a variety of damage claims arising from the breaches. Blackwell Summ.Judg.Aff. ¶¶ 26-27 and 31-35, App. 17-19, 20-22.[2] But the lost sales record was never developed because the "speculation" issue was not raised. Indeed, the district court brushed aside as "irrelevant" *all* matters not directly relating to the single, legal issue raised by Western – whether the New Business Rule barred *per se any* attempt to establish lost profits. 944 F. Supp. at 755, n.1.

Western's reply brief below also dealt only with the New Business Rule, P.App. 20, 21, 26 and 31, and its

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1-17. Other documents filed in the district court and cited in this brief are also included in the Petitioner's Appendix.

[2] Portions of the district court record previously submitted to this court in the appellant's appendix are cited as "App."

response to MindGames' proposed findings of fact confirmed the motion was limited to the New Business Rule. MindGames had proposed a finding relating to royalties exceeding $30 million on *Pictionary*, a comparable adult board game for which Western had served as licensee. P.App. at 36. Western responded such a finding was

> . . . irrelevant to Western's motion for partial summary judgment, which seeks a determination that MindGames cannot introduce evidence of the profits it allegedly lost as a result of Western's alleged breach of the license agreement. The alleged royalties that the licensor of *Pictoinary* received are not relevant to the legal issues raised in Western's motion for partial summary judgment.

P.App. at 37. If Western had argued to the district court MindGames would be unable to prove lost sales and resulting royalties absent a New Business Rule, certainly the royalties of a comparable adult game would be relevant. It was Western's burden to make a *prima facie* case for summary judgment on that issue but it did not attempt to do so or even raise the issue. *Hannon v. Turnage*, 892 F.2d 653, 656 (7th Cir. 1990), *cert. den.*, 498 U.S. 821 (1990).

The majority overlooked the limited scope of the issue Western presented below. The single ground Western asserted – the effect of the New Business Rule – did not require MindGames to develop evidence on the issues of breach and the volume of lost sales. Thus, the issue of whether MindGames could present evidence from which lost royalties could be estimated without excessive speculation was never presented to the court below.

II. The Majority Decision Conflicts with Authority From This Court Prohibiting Affirming Summary Judgment on a Ground Not Raised in the District Court.

The majority stated, "[W]e may of course affirm an award of summary judgment on any ground that has not been forfeited or waived in the district court." Slip op. at 13, citing *United States v. Jackson*, 207 F.3d 910, 917 (7th Cir. 2000).

Such an affirmance is improper, however, where the ground on which it relies was not raised in the district court. *Box v. A & P Tea Co.*, 772 F.2d 1372 (7th Cir. 1985): "[W]e may affirm a summary judgment on any ground that finds support in the record, *but the ground must have been adequately presented in the trial court so that the non-moving party had an opportunity to submit affidavits or other evidence and contest the issue.*" 772 F.2d at 1376 (emphasis supplied; citations omitted).

Western had the burden of demonstrating that it presented the argument to the district court. It made no attempt to do so. In *Meredith v. Allsteel, Inc.*, 11 F.3d 1354 (7th Cir. 1994), *overruled on other grounds, Ahng v. Allsteel, Inc.*, 96 F.3d 1033 (7th Cir. 1996), the court explained that a non-movant's duty to respond is prescribed by the issues raised by the movant: " . . . if Allsteel never asserted this ground before the trial court, we are unable to grant summary judgment on the alternative basis." *Id.* at 1359, citing *Box*. "Because Allsteel did not make this argument, the employees had no duty to respond to it by building a factual record." *Id. See also, Andersen v. Chrysler Corp.*, 99 F.3d 846, 855 n.5 (7th Cir. 1996).

The majority opinion here directly conflicts with this settled law by allowing this court to consider an alternative ground for affirmance regardless of whether it was properly raised in the district court. The full court must rehear this appeal to resolve the conflict the panel has created.

III. MindGames Did No Waive Its Right to Prove Loss of Future Profits.

As required by Fed.R.App.P. 28(b)(2), MindGames set forth the issues presented for review in its main brief. The relevant issue was stated as follows:

> Did the district court err in holding that, under Arkansas law, the New Business Rule barred MindGames' claim for lost profits where the profits consisted of royalties generated by its experienced licensees and were determined by sales, not profits?

MindGames' appeal brief at 1. Western's counter-statement contained only one issue relevant to the proof of lost profits:

> Did the District Court err in holding that under Arkansas law, the New Business Rule precluded a licensor from recovering future profits it allegedly lost as a result of the licensee's alleged breaches of a license agreement to manufacture and distribute a new adult board game?

Western's appeal brief at 1. Thus, the basis for the majority's affirmance was not given by either party as an issue presented to this court. As shown above, that issue could

not have been presented to this court because it had not been raised below.

Apparently assuming (incorrectly) that Western had raised the "speculation" issue below, the majority treated it as fair game on appeal, emphasizing the absence of evidence "from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter, some broad but bounded range of alternative estimates, of copies of 'Clever Endeavor' " would have been sold. Slip Op. at 12 (emphasis in original). The majority referred to an argument Western presented to *this* Court – not the district court – and concluded the "argument was brief but not so brief as to fail to put MindGames on notice of a possible alternative ground for upholding the district court's judgment." *Id.* at 13. The majority then faulted MindGames because, in its reply brief, it "pointed to no evidence from which lost royalties could be calculated to even a rough approximation." *Id.*

MindGames, however, had never been called upon to develop and file such evidence below and limited its filings to the Blackwell affidavits *because the issue of uncertain lost sales had not been raised*. The dissent recognized this.

> It is true that in responding to Western's motion for partial summary judgment MindGames did not provide evidentiary material tending to show the breaches by Western nor that such breaches caused a loss of sales. This should not be deemed a waiver or forfeiture of an opportunity to do so because of Western's complete reliance in its motion on the new business rule

> and *Marvell*, which, if applied, would prevent proof of breach and causation of loss.

Dissent, Slip Op. at 15.

Western's appeal brief did not squarely present the issue, except obliquely in a factually unsupported reference to supposed difficulty of proving lost profits on entertainment products, as a reason for not retreating from the New Business Rule. *See* Western's appeal brief at 30. MindGames *did* respond in its reply brief (at 5 and 15-16) to the point of Western's references (an aspect of its New Business Rule argument), and the bulk of MindGames' reply brief was, of course, addressed to the New Business Rule argument generally.

But it is manifestly unfair to hold, as the majority did, that the *en passant* references to speculation in Western's appeal brief (a) in fact constituted an argument on an issue Western had not even included in its statement to this court of the issues presented, (b) should have been read by MindGames as raising a separate issue Western was precluded from raising because not presented below, and (c) required MindGames to cite proof it had never been called upon to file below.[3]

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[3] New Business Rule aside, the majority disregarded Arkansas's liberal damage rule permitting lost profit damages in entertainment cases even where the claimant is inexperienced. *Finley v. North River Records, Inc.*, 148 F.3d 913, 918-19 (8th Cir. 1998) (allowing a fledgling music concert promoter to recover lost future profits under Arkansas law despite the absence of prior successes). The uncertainty preventing recover of lost profits relates to the *fact* of damages, not the *amount*. *Jim Halsey Co. v. Bonar*, 683 S.W.2d 898, 903 (Ark. 1985) (concert promoter could claim lost profits on future

The MindGames' constitutional right to a jury trial must not be rendered so fragile and evanescent as to be taken away on such attenuated grounds. Waiver ordinarily means the conscious relinquishment of a known right. *Medcom Holding Company v. Baxter Travenol Laboratories, Inc.*, 106 F.3d 1388, 1396 (7th Cir. 1997). On this record, there was no waiver by MindGames. If any wavier occurred here it was by Western, which for purposes of the present appeal waived the issue of whether MindGames had evidence from which a factfinder could make a reasonable estimate of lost royalties, by not raising that issue in the district court. On remand Western may be permitted to raise that issue in a new summary judgment motion; what controls here is that it was *not* raised in the motion that is the subject of this appeal.

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concerns despite no evidence of successful earlier promotions). For purposes of the instant summary judgment motion the "fact" of damage was not questioned and must be presumed.

Under such precedents, MindGames is entitled to file evidence such as market studies and statistical analysis by experts in game marketing, comparisons of sales results in geographical areas where appropriate promotions and advertising o[illegible]s were not used versus those where they were used, projections of sales patterns established prior to the breach, utilizing sales forecasts generated by Western, sales performance by comparable products and correlation of sales to advertising expenditures that were made and that should have been made.

IV. The Majority Opinion Conflicts with Supreme Court Summary Judgment Precedent by Improperly Drawing Controlling Inferences Against MindGames.

The panel unanimously rejected the district court's ground for granting summary judgment. In concluding it could nevertheless affirm summary judgment the majority drew inferences against MindGames, the nonmoving party, and thus violated guidelines set by the Supreme Court and reiterated by this court.

Anderson v. Liberty Lobby, Inc., mandates that "at the summary judgment stage the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial," 477 U.S. at 249, and that "evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor." *Id.* at 255. Decisions from this court reiterate that point, *e.g. Bombard v. Fort Wayne Newspapers, Inc.*, 92 F.3d 560, 562 (7th Cir. 1996).

Overuse of Fed.R.Civ.P. 56 is recognized by this court as infringing upon Seventh Amendment rights and causing meritorious cases to be dismissed without benefit of the record being developed at trial. This Court said in *Wallace v. SMC Pneumatics, Inc.*, 103 F.3d 1394, 1397 (7th Cir. 1997):

> The expanding federal caseload has contributed to a drift in many areas of federal litigation toward substituting summary judgment for trial. The drift is understandable, given caseload pressures that . . . sometimes make it difficult to find time for civil trials in the busier federal districts. but it must be resisted. . . . "

(Citations omitted.) *See also Door Systems, Inc. v. Pro-Line Door Systems, Inc.*, 83 F.3d 169, 172 (7th Cir. 1996), and JAMES W. MOORE, ET AL., MOORE'S FEDERAL PRACTICE § 56.50 at 56-313, -314 (3d ed. 1997).

The majority's decision disregards such concerns. It concluded without a trial, on a record limited to the New Business Rule issue, that MindGames would not be able to prove the volume of lost sales. In so doing, the majority not only disregarded the limitations on the record made below, but also indulged in at least two critical anti-MindGames inferences.

First, after acknowledging more games possibly could have been sold if properly marketed by Western, the majority found "an equally if not more plausible possibility is that the reason Western didn't market the game more vigorously was that it correctly (sic!) sensed that demand had dried up." Slip Op. at 11-12.

Anderson, 477 U.S. at 255, forbids preferring the negative inference over the one favoring MindGames. The majority also begs the question of why demand "dried up," if that happened. A jury could infer either that demand could not be met and/or fell because of the nature of the breaches described in ¶¶ 26 and 27 of the Blackwell summary judgment affidavit (App. 17-19): confusion and dissatisfaction among retailers and consumers stemming from poorly printed and wrongly colored box wraps, defective board pieces, missing components (game rules, board pieces, venture cards), incorrectly cut and duplicated clue cards, failure to deliver promised TV

ads, an unauthorized price increase, late TV ad campaigns, wrongly targeted radio ad campaigns, underspending on ads and other breaches. The majority also overlooked that Western gave promotion and sale preference to other games, very likely because they required it to pay much lower royalties. App. 19 (¶ 27j); App. 96 (¶ 5(u)). Western itself did not believe demand for *Clever Endeavor* had dried up. Its 1991 annual report to stockholders stated that *"Clever Endeavor . . .* should enjoy significant sales in the coming year." *See* Blackwell Aff. ¶ 20, App. 15.

The majority's second unwarranted inference is that MindGames' failure to terminate its contract with Western and seek distribution of "Clever Endeavor" by other means" . . . is telling evidence of a lack of commercial promise unrelated to Western's conduct." Slip. Op. at 12. The majority overlooked evidence that Western destroyed MindGames' opportunity to seek other licensees by illegally dumping many thousands of copies of the game at less than 25% of its contractual wholesale price. *See* Blackwell Aff. ¶ 32 (App. 20-21) and Blackwell Supp. Aff. ¶ 5(1) (App. 84).

Such oversights illustrate the hazard for the court and the potential for injustice for the appellant when the court goes outside the issues developed below and in the appeal briefing to affirm.

Whether in the granting of summary judgment by a district court or the affirming of summary judgment by the court of appeals, judicial fact-finding and denying the nonmovant the benefit of permissible inferences conflicts with settled precedent from the Supreme Court and this

court. The full court should grant review to preserve the petitioner's right to a jury trial and to remind lower courts that the decisions in *Celotex Corp. v. Catrell*, 477 U.S. 317 (1986); *Anderson*, 477 U.S. at 242, and *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), should not be read as weakening the prohibition against judicial factfinding.

V. The Majority Opinion Wrongly Deprived MindGames of the Chance to Recover Even Nominal Damages and the Attorney Fees Recoverable under Arkansas Law and by Contract Based on a Misapprehension of MindGames' Complaint and Applicable Procedural Rules.

The majority erroneously denied MindGames' statutory opportunity for and contractual right to attorney fees on the mistaken ground that "MindGames does not seek [nominal damages]" and thereby "may have lost a chance to obtain significant attorney fees." Slip Op. at 3.

Even if limited to nominal damages, were MindGames to prevail in its breach of contract action it could apply for an award of reasonable attorney fees pursuant to Ark. Code Ann. § 16-22-308 (Repl. 1994) and *Dawson v. Temps Plus, Inc.*, 987 S.W.2d 722, 729 (Ark. 1999). MindGames also has a right to recover all costs and reasonable attorney fees upon proving breach by Western pursuant to ¶ 21 of the License Agreement. App. 64.

MindGames' complaint seeks damages of $5 million or as proved at trial, together with "attorney fees and all

other proper relief." P.App. at 43.[4] Nominal damages need not be specially pleaded. *Tacket v. Delco Remy Div. of General Motors Corp.*, 937 F.2d 1201, 1205 (7th Cir. 1991).

An inquiry as to nominal damages and attorney fees would not even have begun until MindGames prevailed at trial on the issue of breach. *Marsh & McLennan v. Herget*, 900 S.W.2d 195, 197 (Ark. 1995). Such issues are raised as supplemental collateral matters only after the party seeking fees has "prevailed" in the main action. The breaches of contract outlined in ¶¶ 26 and 27 of the Blackwell summary judgment affidavit (App. 17-19) were not reached below.

The court's ruling also needlessly casts a *res judicata* cloud over MindGames' right to claim attorney fees and other costs for work done on the lost royalties claim in the context of prosecuting its breach of contract damage claims other than those that were the subject of the two motions for partial summary judgment.[5] These other claims were dismissed without prejudice to enable this appeal to go forward (P.App. 46, ¶ F) and may be recommenced within sixty days after this court's decision pursuant to a tolling agreement.

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[4] MindGames originally filed its complaint in the Eastern District of Arkansas as Civil Action No. 94 290 and it was transferred to the Eastern District of Wisconsin as Case No. 94-CV-998. The complaint is a part of Docket No. 1 in Case No. 94-CV-998.

[5] These claims are described in the Blackwell summary judgment Aff. ¶¶ 31-34. App. 20-21.

Western did not argue either here or below that MindGames had waived or was disqualified from claiming nominal damages or attorney fees. This court's gratuitous ruling was based upon a misapprehension of MindGames' complaint, which pleaded the predicates for nominal damages and specifically sought attorney fees, and overlooked the fact that an application for nominal damages and/or attorney fees would have been premature. The court's language regarding nominal damages and attorney fees should be withdrawn or changed and, if not for any of the other reasons advanced in this petition, the case should be remanded to the district court for further proceedings regarding these issues.

CONCLUSION

We are aware of the odds against obtaining a rehearing, especially *en banc*. We request them nevertheless in reliance on this court's "deeply embedded . . . concept of fair play and substantial justice." *English v. Cowell*, 10 F.3d 434, 437 (7th Cir. 1993). The right to a jury trial is seriously compromised if a case like this can be thrown out on grounds not properly raised below or here and without giving MindGames a fair chance to develop and offer proof of its damage claim.

Petitioner requests that the parts of the panel's decision (a) affirming the judgment and holding that MindGames' claim for lost royalties is too speculative (Slip Op. 10-13) and (b) finding that MindGames has waived the opportunity to obtain nominal damage and attorney fees

(Slip Op. 2-3) be vacated and that this case be remanded to the district court for further proceedings.

Respectfully submitted,

/s/ E. Campion Kersten
E. Campion Kersten
Matthew T. Fricker
Attorneys for the Petitioner,
MindGames, Inc.

CERTIFICATE OF SERVICE

I certify that on July 6, 2000, two copies of the foregoing petition for rehearing *en banc* and petitioner's appendix were served by overnight delivery upon Richard E. Saldinger and Wendi Sloane, attorneys for Western Publishing Company, Inc., at their address of record.

/s/ E. Campion Kersten
E. Campion Kersten

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UNITED STATES COURT OF APPEALS

For the Seventh Circuit
Chicago, Illinois 60604

August 22, 2000

Before

Hon. Thomas E. Fairchild, *Circuit Judge*

Hon. Richard A. Posner, *Circuit Judge*

Hon. Diane P. Wood, *Circuit Judge*

No. 98-1879

MINDGAMES, INC.,

Plaintiff-Appellant,

v.

WESTERN PUBLISHING COMPANY, INC.,

Defendant-Appellee.

Appeal from the United States District Court for the Eastern District of Wisconsin.

Nos. 94-C-552 & 94-C-998

Lynn Adelman, *Judge.*

ORDER

On July 6, 2000, plaintiff-appellant filed a petition for rehearing and petition for rehearing *en banc* and on August 8, 2000 defendant-appellee filed an answer with appendix. A majority of the judges on the original panel have voted to deny the petition. None of the active judges has requested a vote on the petition for rehearing *en banc*. The petition is therefore **DENIED**.

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* Hon. Thomas E. Fairchild voted to grant the petition for rehearing.

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY

Plaintiff,

v.

Case No. 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

v.

Case No. 94-C-998

WESTERN PUBLISHING COMPANY, INC.

Defendant.

AFFIDAVIT OF G. LAWRENCE BLACKWELL, III IN OPPOSITION TO THE SUMMARY JUDGMENT MOTION OF WESTERN PUBLISHING COMPANY, INC.

STATE OF CALIFORNIA)
) SS.
SAN MATEO COUNTY)

G. Lawrence Blackwell, III, being first duly sworn on oath deposes and says:

1. I am the President and principal stockholder of MindGames, Inc. I make this affidavit of my own knowledge in opposition to the motion of Western Publishing Company, Inc., for partial summary judgment.

2. My background and professional experience are as follows. I have an undergraduate degree in business management and recently received an MBA from the Stanford Graduate School of Business. I have evaluated marketing programs for a Wall Street firm for companies seeking financing in the $2 million to $20 million range. I have acquired substantial knowledge of the game business through my own experience with *Clever Endeavor* and other games in the United States and in certain foreign markets. I have kept up with trade publications related to games and game products and attended many toy trade shows in the United States and abroad. I have consulted and exchanged information with many people involved in the game industry, including inventors, manufacturers and marketers. I have licensed game products nationally and internationally. For four years I have been a speaker at the Game Inventors of America Conference. I also conducted workshops at that conference for several years.

3. I am the inventor of an adult board game called *Clever Endeavor*. A patent was issued to me for the game on March 12, 1991, Patent No. 4,998,735. A copy of the patent is included in the appendix to this affidavit at page 1 ("App. 1"). All documents in the appendix are incorporated by reference in this affidavit.

4. The patent application was filed on December 18, 1989 at the same time I assigned the patent rights to MindGames, Inc.

5. I obtained a trademark for *Clever Endeavor* in the United States in 1990 and thereafter registered it in eleven foreign countries.

6. Pursuant to the assignment referred to above, MindGames owns the rights to *Clever Endeavor*. All rights of Western and/or Games Gang to the game under the license agreement and the extensions of the license agreement have expired. They claim no further rights in the game.

MINDGAMES' PRELICENSE SUCCESS WITH *CLEVER ENDEAVOR*

7. MindGames was established to manufacture and market *Clever Endeavor* and other games. MindGames did in fact market *Clever Endeavor* from its introduction in February 1989 until it signed the license agreement with Western and Games Gang in March 1990. At the time the license agreement was entered into, *Clever Endeavor* was not a new and unproven product. It had been introduced during the February 1989 American International Toy Fair in New York, the largest and most important toy trade show in North America and Asia. All major toy buyers and thousands of smaller buyers saw the game at both the 1989 and February 1990 Toy Fairs before it was licensed.

8. MindGames began shipping *Clever Endeavor* in September 1989. In its first 75 days on the market, MindGames sold about 30,000 copies of *Clever Endeavor*,

through more than 400 retailers, coast-to-coast. Western and Games Gang were so interested in *Clever Endeavor* that they handled the sales and exhibition of *Clever Endeavor* at the February 1990 Toy Fair, more than a month before entering into the license agreement. They also sold and marketed the game themselves for more than a month before the license agreement and directly received orders for the game during that time. Western and Games Gang had firsthand information and experience with the game at the time they entered into the license agreement based on the foregoing and their own due diligence investigation.

9. From the time of its introduction *Clever Endeavor* obviously had tremendous appeal to retailers and consumers. Prior to the license the press praised *Clever Endeavor* and the game won most of the available awards, including a Parents' Choice Gold Award, an Addy Award, an award from Mensa and inclusion in numerous "top five" and "top ten" games lists in 1989. Among those who wrote MindGames to say how much they appreciated or enjoyed *Clever Endeavor* were O.J. Simpson (at a less troubled time in his life), the movie actress Sally Fields, the business magnate and former cowboy star Gene Autry and President Bush. Western was made aware of these matters during license negotiations.

10. Hundreds of *Clever Endeavor* game players mailed in survey cards and provided positive feedback on the game. Western was aware of these cards.

11. During the 1989 Christmas season many retailers sold out of *Clever Endeavor* and reported to

MindGames that the game was selling quicker than any they had ever handled, including *Trivial Pursuit*.

THE ESTABLISHED SUCCESS OF WESTERN PUBLISHING COMPANY AND THE GAMES GANG, LTD., IN THE GAME BUSINESS

12. I am familiar with the Annual Report issued by Western Publishing Group, Inc., for the year ending January 28, 1989. On page 6 Western acknowledges that it is printer, co-licensee and joint marketer (with Games Gang, Ltd.) of *Pictionary*, "America's best-selling board game for the second consecutive year," and had shipped over 7,000,000 copies of *Pictionary*. *See*, App. 10.

13. On page 7 of the same report Western describes itself as "the second largest game company in the United States." *See* App. 11.

14. On pages 16 and 17 of the same document Western reports $551,358,000 in total sales. It further indicates assets of $311,191,000 and liabilities of $138,426,000, producing a net worth of $172,765,000. *See*, App. 12, 13.

15. During the negotiations for the March 1990 license agreement I was aware of Games Gang's reputation as an experienced, highly successful marketer of games. I knew, for example, that its sales people (operating under a different name at the time) had sold *Trivial Pursuit* and that Western had printed it. I was also aware that Games Gang and Western were the co-licensees for *Pictionary*. The Games Gang people I negotiated with and Games Gang sales personnel I spoke with at the 1990 Toy Fair in New York confirmed Games Gang's extensive and successful background in marketing these and other

games. I licensed *Clever Endeavor* to Games Gang and Western because of their experience and success in the game business and their extensive manufacturing and sales capabilities.

16. I am familiar with the Form 10-K for the fiscal year ending February 3, 1990 that Western filed with the Securities and Exchange Commission. On page 4 Western states, "Royalty rates paid by Western Publishing Company, Inc., generally range from 6% to 10% of the invoiced price of the merchandise. . . . " *See*, App. 14. Western agreed to a 15% royalty for *Clever Endeavor*.

17. Attached hereto as App. 15, 16, 17 are pages 113, 114 and 145 of the deposition of Mark E. Hartelius, which I attended. Mr. Hartelius was a senior director of game and puzzle development at Western and became its vice president for all product development (except publishing). Mr. Hartelius negotiated approximately forty royalty contracts while at Western. All of them were at royalty percentages below 8%.

WESTERN PUBLISHING COMPANY'S AND GAMES GANG'S FORECASTS OF SUCCESS FOR *CLEVER ENDEAVOR*

18. By the time of the license agreement negotiations in late 1989 and early 1990 it was common knowledge in the game industry that *Trivial Pursuit* had made more than $75 million in royalties for its inventors and that *Pictionary* had earned upwards of $30 million in royalties. Representatives of Games Gang represented to me at the 1990 Toy Fair in New York that based upon their knowledge of the game and the market response to

it as that time, they regarded *Clever Endeavor* as the "next *Pictionary*" and "next *Trivial Pursuit*."

19. The representatives of Western and Games Gang with whom I negotiated the license agreement repeatedly expressed their awareness of the fact that *Clever Endeavor* was a game of proven appeal and destined for great success. This is also reflected in the fact that the license agreement provides for royalty payments of 15% of sales. The only other games I know of for which Western paid a 15% were *Pictionary* and *Balderdash*, both of which were very successful, producing world-wide royalties in excess of $10 million for *Balderdash* and $50 million for *Pictionary*. Most of Western's license agreements with game inventors call for royalty rates of 3% to 7%, according to Western's published data, *see*, ¶¶ 16 and 17 above.

20. Page 18 of the appendix is from Western's 1991 Annual Report. It acknowledges the decline in the national economy but nevertheless states:

> We also continued to improve our position in the proprietary game segment with the successful launch of several new juvenile and adult board games . . .
>
> . . . We are the printer, co-licensee and joint marketer of *Pictionary* with the Games Gang, Ltd. Games Gang, Ltd., has also successfully launched *Balderdash* and *Clever Endeavor*, family party games which should enjoy significant sales in the coming year. We are a part owner of Games Gang, Ltd., their printer and often co-licensee and/or co-marketer.

In my experience it is very significant that a public company of the size and reputation of Western would make such a representation.

21. Attached hereto at App. 15-25 for comparison purposes is a draft license agreement which was given to me to read and consider by Western and Games Gang during our contract negotiations and represented to be the company's "standard" form of license agreement.

22. Attached hereto at App. 26-45 is a copy of the license agreement entered into between the parties in March 1990. In [sic] contains numerous representations, promises and warranties not found in the "standard agreement" which I believe Western and Games Gang would not have agreed to if they had regarded *Clever Endeavor* as an unproven game – one without a clear claim to substantial sales. These include (in addition to the high royalty rate):

a. Giving MindGames a voice in decisions on product design, product development, public relations, promotion, pricing, advertising, marketing and allowances. *See*, ¶ 7(a), App. 31.

b. Agreeing to consult with MindGames monthly regarding forecasts and production plans, as well as agreeing to outsource production if required. *See*, ¶ 7(d), App. 31-32.

c. A warranty that the game and game products are to be of workmanlike quality in conformance with industry standards and standards and samples approved by MindGames. *See*, ¶ 8, App. 32.

d. A warranty by Games Gang that it would diligently and actively promote, market and sell the game during each year of the agreement. *See*, ¶ 8(b), App. 32.

e. A guarantee by Western that it would treat *Clever Endeavor* equally in production and distribution with its own games and other printed products. *See*, ¶ 8(c), App. 33.

23. Once the license agreement was made, whether or not MindGames made profits on its own operations and whether or not MindGames was a "new business" became completely irrelevant to its royalty rights because all manufacturing, warehousing, shipping, promotion, marketing and sales were performed by Western and Games Gang. MindGames had almost no expenses related to the *Clever Endeavor* license. Consequently, its revenue flowing from the license equalled pretax income from the license for practical purposes. Similarly, royalty payments did not depend on whether Western's or Games Gang's operations were profitable to them, because royalties were determined by sales. *See*, App. 28. MindGames did in fact report profits after the game was licensed.

24. Because royalty revenue was to accrue to MindGames without expenses, a reasonable estimate of MindGames' damages in the category referred to in ¶ 35 below can be derived from an estimate of the sales *Clever Endeavor* was likely to have achieved had Western and Games Gang not breached the agreement.

25. MindGames makes no claim for damages for the period prior to the license agreement.

CONTRACT BREACHES BY WESTERN AND GAMES GANG

26. Western breached ¶ 8 of the license agreement (App. 32-33) in the area of its manufacturing responsibilities, including the following:

a. Western negligently printed 50,000 boxes in an incorrect color with poorly printed box wraps. It nevertheless insisted on selling them because of tight schedules. The unappealing boxes caused confusion and dissatisfaction among retailers and consumers in *Clever Endeavor's* start-up year.

b. Western knowlingly sold *Clever Endeavor* games with defective board pieces it had purchased at a 50% discount without timely disclosing to MindGames either the defects or the discount. This also proved very damaging to *Clever Endeavor* in its critical start-up year.

c. Western sold numerous games with missing components, such as game rules, board pieces and venture cards, and with incorrectly cut and duplicated clue cards.

27. Western and Games Gang committed numerous breaches of the license agreement with respect to their promotion, sales and marketing obligations which proved fatal for *Clever Endeavor*. In October 1990, *Clever Endeavor's* mass market launch season, Games Gang fired its chief executive officer and president, its chief financial officer and its vice president of marketing and did not replace them. Its only remaining executives had no significant marketing experience. It appeared to me that Western took no steps to rectify the effects of these events on

Clever Endeavor. The known breaches of contract and performance warranties in the area of marketing on the part of Western and Games Gang include the following:

a. Unknown to MindGames, in May 1990 Games Gang proposed lowering its sales force's commissions on *Clever Endeavor*, reducing their incentive.

b. Without MindGames' consent and without adequate funds, Games Gang promised retailers television ads. Retailers ordered in reliance on this. Games Gang then reneged, causing retailers to cancel orders in large numbers.

c. Without obtaining MindGames' required consent, retailers were notified on December 31, 1990 of a price increase of nearly 17%. A "correction letter" cancelling the increase was not sent until three months later.

d. Games Gang ran *Clever Endeavor* ads for the critical mass market introductory Christmas season of 1990 late. This caused retailers to panic and seek to escape from an over-inventory position. The late advertising also greatly reduced reorders.

e. Radio ad campaigns in important markets like Chicago and Minneapolis were poorly handled. Ads ran too long and became stale and were not as represented.

f. Ad funds were wasted by running ad campaigns on wrongly-targeted radio stations (as if advertising a rock-related product on an "elevator music" station).

g. Games Gang permitted the public relations firm it selected to fail to perform promised public relations activities.

h. In 1990, 1993 and 1994 Western and Games Gang failed to spend the minimum amount for advertising required by the license agreement.

i. In 1991, 1992 and 1993 Western ignored MindGames' requests for information on planning and execution of ad campaigns.

j. Western repeatedly gave preference over *Clever Endeavor* in manufacturing and distribution to its other games. This also occurred with respect to derivative *Clever Endeavor* products such as a second edition and a children's edition. MindGames believes this was due to the higher royalties payable on *Clever Endeavor*.

MINDGAMES' DAMAGE CLAIMS

28. I am informed that Western's summary judgment motion attempts to bar MindGames, Inc., from seeking "lost profits" on the ground that Arkansas law does not permit a "new business" to recover "lost profits." MindGames does not claim "lost profits" in this case but rather claims loss of royalties (and other damages) based upon the failure of Western and its co-licensee, Games Gang, to fulfill their obligations under the license agreement. MindGames' damage claims at the present time are set forth below.

29. MindGames' first claim for royalties is based upon the fact that Western continued to manufacture and

sell *Clever Endeavor* throughout 1993, after the initial three-year term of the license. MindGames believes that Western became obligated under the license agreement to pay MindGames the difference between $1.5 million and the royalties actually paid during the first three years by so doing. Despite Western's recent invention, there was no agreement to the contrary and MindGames relied on the 1990 agreement. Western has paid royalties to date of approximately $535,000 for that period. It therefore still owes MindGames approximately $965,000, plus interest. MindGames has never waived its claim to these royalties.

30. MindGames' second claim for royalties is based upon the fact that Western continued to manufacture and sell *Clever Endeavor* through June of 1994, after the first one-year license extension period. By selling the game through a second extension period Western became obligated to pay MindGames additional royalties on sales during the first one-year extension. Western has paid only part of this obligation and owes MindGames the balance, plus interest. Sales made by Western subsequent to January 31, 1994 were not pursuant to a permitted liquidation. Further, most unit sales for the year ending January 31, 1995 occurred after any such liquidation period would have expired. MindGames has not waived its claim to these royalties.

31. MindGames' third claim for royalties is based upon the fact that Western sold about 61,000 copies of *Clever Endeavor* in June 1994. The royalties payable to MindGames on these sales have not all been paid. The balance is owed to MindGames, plus interest.

32. MindGames' fourth damage claim is based upon the fact that Western breached its obligation to obtain MindGames' consent to sell games for less than $16.95 per game when it liquidated many thousands of copies of the game at $4. MindGames did not consent and would not have consented to such a liquidation because of its destructive effect. This liquidation destroyed *Clever Endeavor* as a commercially viable game and any possibility of licensing it to another business was substantially impaired.

33. MindGames further claims damages for Western's failure to disclose material facts regarding Western's assumption of Games Gang's contractual obligations. As required by the license agreement, Western obtained MindGames' permission to assume all of Games Gang's obligations and benefits under the license agreement in 1992. Western failed to disclose, however, that it had to give up a substantial percentage of commissions to Games Gang on all future sales. This seriously impaired Western's incentive to aggressively market *Clever Endeavor*. Western and Games Gang had already expressed to me their concerns about "low profits." Had MindGames known the assumption agreement would reduce the profitability of *Clever Endeavor* for Western, MindGames would not have consented to those terms.

34. MindGames also claims damages based upon Western's failure to spend required amounts on advertising and promotion. It owes MindGames 50% of all such unspent funds. The amount of this claim is undetermined at this time, pending further discovery.

35. MindGames' largest damage claim (the only one addressed by Western's motion for summary judgment) is based upon the multiple breaches of contract by Western and Games Gang in manufacturing and marketing *Clever Endeavor* referred to above, the effect of which was to destroy the value of the game in the marketplace and to prevent it from reaching even a fraction of the potential that was widely recognized for it when the license agreement was entered into. The accumulation of breaches by Western and Games Gang made it impossible for *Clever Endeavor* to reach more than a small fraction of the royalty income it had been well on its way toward generating. MindGames' damages for this element are substantial and depend on how closely the jury believes *Clever Endeavor* would have approached the royalty levels of *Pictionary* and *Trivial Pursuit* had it been handled as the licensing agreement required.

RESPONSE TO WESTERN'S PROPOSED FINDINGS OF FACT

36. **Proposed Fact 2.** The correct address for MindGames is 1400 West 43rd Avenue, Pine Bluff, Arkansas 71603.

37. **Proposed Fact 4.** MindGames' causes of action arose in Arkansas, New York and Wisconsin. MindGames continues to believe that its action against Western was properly venued in the State of Arkansas.

38. **Proposed Finding 5.** I did not form MindGames for the sole purpose of manufacturing *Clever Endeavor*. MindGames was formed to develop and publish a number of games and eventually toys. Although

Clever Endeavor was MindGames' only published product, MindGames had several other games, some at the prototype stage, that it desired to launch but was unable to market because of lack of cash caused by Western's breaches of *Clever Endeavor* license agreement.

39. **Proposed Finding 6.** Contrary to Western's proposed "Fact" 6, I did not begin to believe that *Clever Endeavor* would enjoy success similar to *Pictionary* and *Trivial Pursuit* until after MindGames great sales success with the game during the 1989 Christmas season, the extraordinarily enthusiastic reception it received in the American International Toy Fairs [sic] in New York of 1989 and 1990, after it won several awards and distinctions, after it appeared on the *Today Show* and the cover of the *"Weekend Section"* of the *Chicago Tribune*, nationwide on CNBC and on National Public Radio, after consumers wrote saying how much they liked the game and after independent assessments of the game by members of the industry received at the toy fairs and elsewhere. This belief was confirmed by representations made by Games Gang and Western personnel at the 1990 Toy Fair that they regarded *Clever Endeavor* as the "next *Trivial Pursuit*" and "next *Pictionary*." It is not true that I formed my beliefs about the market potential of *Clever Endeavor* without having discussed with persons in the industry what made *Trivial Pursuit* and *Pictionary* successful.

40. **Proposed Finding 7.** The market testing of *Clever Endeavor* conducted by MindGames was much more than "minimal." Further, MindGames did not limit its market testing to my relatives and friends. Tests were run with groups not associated with Blackwell.

41. **Proposed Finding 8.** Western misleadingly understates the extent of MindGames' marketing activities during 1989. Such marketing activities included: national public relations by Pezzano & Co., the public relations firm which launched *Pictionary* and *Trivial Pursuit*, multiple city promotions, radio advertising, print advertising and co-op advertising. The decision to publish *Clever Endeavor* was made after the very strong positive response it received from buyers at the American International Toy Fair in New York in 1989.

42. **Proposed Finding 9.** MindGames did not expect to report a profit in 1989, the start-up year for *Clever Endeavor*. The investments required to launch a game often preclude companies from reporting profits in the first year a product is launched, particularly when the product is not available for the entire year. Western proposed finding fails to note that sales of *Clever Endeavor* did not commence until September 1989. MindGames' 1989 income statement relates to the entire year. MindGames reported profits after making the *Clever Endeavor* license agreement.

43. **Proposed Finding 10.** This proposed finding is incomplete. I met with the president and vice president of The Games Gang in December 1989. A few weeks later I met with them again and with an executive vice president of Western Publishing Company. MindGames was at that time seeking a production joint venture as one of the possible ways to insure sufficient product supply for 1991. Western and Games Gang preferred to license the game. Lengthy negotiations led to the *Clever Endeavor* license agreement which was signed on March 30, 1990.

44. **Proposed Finding 11.** It is true that the license agreement is governed by the laws of the State of Arkansas under the terms of the agreement. During negotiations there was no mention by any representative of Western or Games Gang of the new business rule. In fact, Western wanted the contract to be controlled by Wisconsin law, which, I am informed and believe, does not include the new business rule.

45. **Proposed Finding 12.** This finding does not accurately or completely recite the obligations of Western and Games Gang under the license agreement. The royalty to be paid is not based on the number of games sold but on the dollar volume of net sales as defined in ¶ 4 of the agreement. The contract also requires the payment of the minimum royalties referred to in ¶ 2 of the agreement and ad fund rebates under specified circumstances.

46. **Proposed Finding 13.** Once the licensee sold *Clever Endeavor* into a fourth year, past the inventory liquidation period, the licensees were required to pay MindGames $1.5 million less royalties received, pursuant to ¶ 2 of the license agreement. In all other respects proposed finding 13 appears to be accurate.

47. **Proposed Finding 14.** The reason given for the reduction in advertising and promotion is incorrect. The representatives of Western and Games Gang who negotiated with me on this issue were not satisfied with the profits they were receiving and sought the amendment as a way to increase their profits on *Clever Endeavor*.

48. **Proposed Finding 15.** Western was responsible for the duties and obligations of Games Gang from the first day of the original license agreement. Western did

obtain MindGames' written consent to the sublicense agreement of February 1992 but in so doing omitted material facts and misrepresented the transaction. MindGames was not informed that the terms of the deal required Western to give up commissions on *Clever Endeavor*, which reduced the incentive of Western to sell *Clever Endeavor*. MindGames would not have agreed to the terms of the sublicense agreement had it been aware of this. Also, Western served as the exclusive licensee of *Clever Endeavor* in the United States and its territories and possessions, with Games Gang until the 1992 assumption agreement, from the period beginning March 30, 1990 through June 1994. Western's license of *Clever Endeavor* did not terminate on January 31, 1994 because it sold the game as late as June 1994.

49. **Proposed Finding 16.** The fiscal-year/units-sold correlations are off by one year. Each should be one year later. In Fiscal 1991, 188,250 units (rather than 165,000) were sold; in addition, 61,716 games were sold in fiscal year 1995.

/s/ G. Lawrence Blackwell, III
G. Lawrence Blackwell, III

Subscribed and Sworn to before me this 8th day of July, 1996.

/s/ Paul J. Prochaska
Notary Public, State of California
My commission 17 Sept. 1999 exp.

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.,

Plaintiff,

v. Case No. 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

v. Case No. 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

SUPPLEMENTAL AFFIDAVIT OF G. LAWRENCE BLACKWELL, III, IN OPPOSITION TO (1) NEW ISSUES RAISED IN WESTERN'S SUMMARY JUDGMENT REPLY BRIEF, (2) WESTERN'S RESPONSES TO MINDGAMES' PROPOSED FINDINGS OF FACT AND (3) WESTERN'S MOTION TO STRIKE SUMMARY JUDGMENT AFFIDAVIT

STATE OF CALIFORNIA)
) ss.
SAN MATEO COUNTY)

G. Lawrence Blackwell, III, being first duly sworn, on oath deposes and says:

1. I have been the principal operating officer of MindGames, Inc. ("MindGames") since its inception. I

make this affidavit of my personal knowledge in response to (1) the new issues raised by Western Publishing Company, Inc. ("Western") in its summary judgment reply brief, (2) Western's responses to MindGames' proposed findings of fact and (3) Western's motion to strike my summary judgment affidavit dated July 8, 1996.

2. The "Agreement" referred to in this affidavit is the *Clever Endeavor* licensing agreement among MindGames, Western and The Games Gang, Ltd. ("Games Gang") signed March 30, 1990, together with the two written addenda to the Agreement signed in 1991 and 1992. There is no other agreement, addendum or amendment signed by the parties. Under ¶ 27 of the Agreement (*see*, page 38 of the appendix to my first affidavit), as would also have been the case under ¶ 16 of Western's and Games Gang's standard licensing agreement (*see, id.*, App. 24), Western and Games Gang are jointly and severally liable for any breach of the Agreement.

3. When I signed my summary judgment affidavit on July 8, 1996, I had read all of the documents referred to both in that affidavit and this one.

4. All of the documents contained in the attached appendix are incorporated by reference in this affidavit. Those with Bates numbers prefaced with "WP" are true copies of documents provided by Western in Discovery in this case. Unnumbered documents are MindGames business records of which I am the custodian.

5. In the memorandum in support of its motion to strike my July 8, 1996 summary judgment affidavit, Western challenges the basis for my personal knowledge

and other aspects of certain facts contained in that affidavit. The following, which is not exhaustive, indicates some of the sources of my personal knowledge for the parts of my affidavit specifically challenged by Western, in the order of their appearance in Western's memorandum.

(a) ¶ 23. I negotiated the Agreement for MindGames. It has always been my understanding that the royalties to be received by MindGames are unrelated to the profits, if any, MindGames reported as a whole and to the length of time MindGames had been in business. Neither the "new business rule" nor the period of time MindGames had been in business were ever brought up in the negotiations. Under the Agreement Western and Games Gang had the exclusive rights to manufacture, market, promote, sell and distribute *Clever Endeavor* in the United States. By licensing *Clever Endeavor*, MindGames could no longer make and sell the game in the United States and became completely dependent on Western and Games Gang for any and all income in its main asset. At the time I negotiated the Agreement for MindGames, I was well aware that neither Western nor Games Gang was a "new business." Each was well established in the game business. I would not have licensed *Clever Endeavor* to them otherwise. My knowledge regarding ¶ 23 is based on my own understanding of the Agreement, my personal knowledge of the negotiations regarding the Agreement and the performance of the parties under the Agreement for more than four years.

(b) ¶ 24. Based upon my personal observation and experience as president of MindGames, I know that an estimate of sales will provide an accurate estimate of MindGames' damages because

MindGames received royalties based upon sales at virtually no cost to itself. As a businessman, I am aware that sales predictions can be made based upon reasonable supporting evidence. I know that Western made sales predictions for *Clever Endeavor* on which it based its game inventory buildup for supplying the market and avoiding product shortages. Western undoubtedly made such sales predictions for its games every year since at least 1990. WP-1604 (App. 1) shows that in or before April of 1991 Western and Games Gang made sales predictions for their jointly handled games for fiscal 1993. Furthermore, WP-2040 (App. 4) shows that Western predicted its profit on *Clever Endeavor*. Western has not provided unredacted copies and supporting detail for either its own or Games Gang's forecast of *Clever Endeavor* profits after it licensed the game, but WP-1793 and 1794 (App. 6 and 7) indicate the forecasts were made.

(c) ¶ 26. I have personal knowledge of the color problems negligently created by Western referred to in ¶ 26(a) because I was told about them by Western and Games Gang in the first week of July, 1990 and from Western and Games Gang documents. The documents include WP-2021 (App. 8) in which Western states that Games Gang is not happy with the ink color but had to accept it because of time and money constraints. In WP-2530 (App. 9) Western acknowledges Games Gang had not approved the wrong color and would accept only 50,000 of the 200,000 defective copies printed. WP-2015 (App. 10) and WP-2033 (App. 11) also refer to the color and problems relating to dullness, fading and excessive darkness. In WP-2467 (App. 12) Western orders a partial correction. In WP-2031 (App. 13) Games Gang talks about ways of using the defective games. Western had plenty of time to

correct the color problems, which they revealed to me in the first week of July 1990, because it did not begin to assemble the defective games until September of 1990, as is clear from WP-2780 and WP-2781 (App. 14 and 15).

My knowledge of Western's use of the defective game pieces referred to in ¶ 26(b) is based upon information given to me by Western and upon numerous Western documents. WP-2669 (App. 16) refers to the large number of defects warranting rejection of an entire lot of pieces. WP-2017 App. 17) reveals that Western accepted these "quality rejected" game pieces as well as 51,000 untested sets and benefited financially in doing so. *See also,* WP-2016 (App. 18). A month later Western notified MindGames it had to use the defective pieces in order to have the games shipped for the "critical pre-Christmas period." (App. 19). Western's overseas supplier advised it could not meet the required quality standards. *See,* WP-2552 (App. 20). I am aware from personal experience that another supplier could have been used to deliver quality components on short notice.

I have personal knowledge of the customer complaints regarding missing and incorrect components referred to in ¶ 26(c). Examples from MindGames' business records are found at App. 25-26.

(d) ¶ 7, third sentence. I know *Clever Endeavor* was not a new and unproven product at the time the license agreement was signed based upon my personal prior experience in marketing the game and from the representations of Games Gang and Western personnel and suppliers. The game was not eligible for "new game" awards, such as "Parents' Choice Awards," in 1990 because it was no longer

new. The Christmas season following the signing of the Agreement was the second for the game and the next Toy Fair was its third.

Before the Agreement, MindGames exposed *Clever Endeavor* to millions of consumers in 1989, assisted by Pezzano & Co., the same PR firm that introduced *Trivial Pursuit* and *Pictionary*. For a year before the Agreement, MindGames sold *Clever Endeavor* through more than 1,000 stores coast to coast and in several national catalogs, including Spiegel, Nieman-Marcus, Sporting Edge and FAO Schwarz [sic]. Before the license the game appeared on national television in 1989 and 1990, including *The Today Show* and *CNBC*. Also before the Agreement the game was covered in major newspapers including *USA Today, The Boston Globe, The New York Times, The New York Daily News, Chicago Tribune, Milwaukee Sentinel, St. Louis Sun, Dallas News* and *The San Francisco Chronicle*. It appeared in national magazines including *Taxi, Entrepreneur, Teen Beat, Games Magazine, Toy & Hobby, Toy Book, Packet Magazine, Playthings* and *Vantage*. I played the game on a National Public Radio outlet, WGN and many other radio stations with substantial audiences. Other radio stations entertained their audiences by playing *Clever Endeavor* on the air before the Agreement. I personally participated in these and other national public relations efforts which exposed *Clever Endeavor* to millions of people nationwide, all prior to the Agreement.

Clever Endeavor was profitable. MindGames' income statements for 1991 and 1992 show MindGames reported profits from *Clever Endeavor*. *See*, App. 27 - 30. MindGames later licensed *Clever Endeavor* to a European licensee for sale in Denmark

and Sweden, which brought in approximately $100,000 in revenue, most of which was "profit" since MindGames had little associated expenses. Western paid MindGames approximately $500,000 in royalties, mostly pure "profit" for MindGames. Western ordered $1.7 million in *Clever Endeavor* inventory (@ $4.80/game) by June 5, 1990 (*see, e.g.*, WP 2672-73, 2396-97), indicating its recognition of established demand for the game. App. 31, 32, 33 and 34.

(e) ¶ 27, fifth sentence. All of this information is based on my personal knowledge, the business records of MindGames and documents supplied by Western.

(f) ¶ 29. The information contained in this paragraph is based on my personal knowledge as President of MindGames and the person who negotiated the license agreement in its behalf and represented MindGames during the more than four years the license was in effect.

(g) ¶ 38, third sentence. The purposes for which MindGames was formed are known to me as the person who formed the company. I know MindGames desired to launch additional games and would have done so but for Western's failure to pay the sums required of it under the license agreement.

(h) ¶ 7, last two sentences. My knowledge of the American International Toy Fairs is based upon my having attended both the 1989 and 1990 Toy Fairs, where MindGames had its own exhibits and meeting areas. Furthermore, Games Gang represented to me that all of the major toy buyers saw *Clever Endeavor* at the 1990 Toy Fair, before the Agreement was signed. Toy Manufacturers of America, the sponsor of the Toy Fair, represents that more than 17,000

buyers attended each of the toy fairs in 1989 and 1990.

(i) ¶ 18. Regarding the financial success of *Trivial Pursuit* and *Pictionary*, Western has thus far refused to provide the information MindGames requested on the royalty payments for *Pictionary*, of which Western was the licensee. As a participant in the industry, I am aware of the "common knowledge" of the huge financial success of *Trivial Pursuit* and *Pictionary* that was at least as great as indicated in ¶ 18 of my affidavit.

(j) ¶ 22. I have personal knowledge of the far more advantageous (to MindGames) provisions of the *Clever Endeavor* license agreement compared with those in Western's "standard" license agreement because during the negotiations I was presented with a copy of what was represented as the Western/Games Gang standard license agreement. In addition, I attended the deposition of Mark Hartelius, who was formerly Western's Vice President for Product Development. He testified that all of the forty or more contracts he negotiated while at Western provided for royalties below 8%, compared to the 13.5%/15% agreed to for *Clever Endeavor*. *See*, page 145 from Hartelius deposition attached at App. 35. Western's Form 10-K for the year ending 2/2/91 indicates that royalties paid by Western "generally range from 6% to 10% of the invoice price of the merchandise." *See*, App. 36-37. As a further indication of Western's expectations for substantial sales of *Clever Endeavor*, its annual report for the year ending 2/2/91 refers to *Clever Endeavor* as a family party game, "which should enjoy significant sales in the coming year." *See*, App. 18 to my prior affidavit.

(k) ¶ 27. My information concerning the firing of key Games Gang personnel in October 1990 is based upon my continuous interaction with Western and Games Gang personnel before, during and after that time.

(l) ¶ 32, second sentence. As the person making the decisions for MindGames, I am well aware of what it agreed to and what it did not and would not agree to with respect to the liquidation, as well as other matters. Western admitted to me that it liquidated a large number of *Clever Endeavor* games for less than 25% of the existing and approved wholesale price without the required consent of MindGames. *See* WP 503 and 1210, App. 38 and 39. As WP-2891-93 (App. 40-42) indicate, Western did seek the consent of Hasbro (a consent not required under the license agreement) to liquidate the *Clever Endeavor* inventory and other games. Hasbro did not consent to liquidate two game titles, but instead required that all finished games and work in progress be destroyed. Western could have sold the *Clever Endeavor* games at the full wholesale price or destroyed the games as alternatives to breaching the license agreement. Instead it chose to breach the contract.

(m) ¶ 33. As a signatory to the 1992 Assumption Addendum, I am aware that Western failed to disclose it had given up a substantial percentage of commissions to Games Gang on future sales of *Clever Endeavor*. Western documents indicate the royalty owed by Western to Games Gang on *Clever Endeavor* was 4% or 9%, depending on whether *Clever Endeavor* surpassed certain cost levels established by Western. The royalties to Games Gang self-evidently reduced Western's profit potential on *Clever Endeavor*. Both Western and Games Gang had

previously complained about their low profit margins on the game. *See*, App. 43-44. Had MindGames known the assumption agreement would thus impair Western's incentive by reducing the profitability of *Clever Endeavor*, it would not have consented to those terms.

(n) ¶¶ 2 and 38. In at least ten instances Western has misrepresented my deposition testimony by mischaracterizing what I said, selective editing or taking answers out of context.

(1) On page 8 of its memorandum on the motion to strike, Western quotes from page 131 of my deposition transcript:

> Q: Do you have an understanding that less than half of the games that make it to the shelf get a second year?
>
> A: I have no idea.

Western omits the very next (clarifying) question and answer:

> Q: You don't have any idea as to what percentage even ballpark; is that correct?
>
> A: If we're including all games, whether – regardless of who they're brought out by, what market, regardless of all other factors, I would imagine it would be less than 50 percent.

See, App. 50.

(2) On page 8 of Western's response to MindGames' proposed findings of fact Western quotes from my deposition:

Q: Now, during that period of time [from March 1988 until September 1989] did you have discussions with anybody in the game industry concerning what features of "Trivial Pursuit" and/or "Pictionary" made them [sic] successful games?

A: No, we did not.

Western misleadingly omitted the follow-up question and answer on page 82:

Q: You just had discussion with your friends about this?

A: Let me back up. I did have discussions after February of '89.

See, App. 48.

(3) On page 9 of its summary judgment reply brief Western asserts MindGames failed to meet its alleged projection of selling 50,000 games in 1989 by selling only 30,000, citing my deposition at pages 105 and 169, and quoting me and Leslie Cox May as characterizing sales prior to the Agreement as "only satisfactory," citing my deposition at page 190 and the May deposition at page 43. The sales projection I actually testified to was 50,000 games or more by July of 1990. *See*, my deposition at page 105, attached at App. 49. Defendant's attempt to equate actual sales through 1989 with a projection assuming six to seven additional months of sales is false and deceptive. Furthermore, neither I nor Ms. May characterized *Clever Endeavor* sales

prior to the Agreement as "only" satisfactory. The word "only" was gratuitously inserted by defendant. We both testified the sales were satisfactory and were in line with MindGames' expectations at that time. *See,* May deposition at 43-44 (App. 45) and my deposition at 189-90 (App. 53-54).

(4) On page 9 of its reply brief Western asserts that MindGames sold *Clever Endeavor* only from September 1989 until January 1990, "at most a five-month period," citing my deposition at 170. But Western's attorneys know MindGames sold *Clever Endeavor* in mid February 1989 and began taking orders the very first day, continuing through March 30, 1990, a period of about thirteen months. *See,* my deposition at 168-69 attached at App. 52.

(5) On page 8 of its memorandum on the motion to strike, Western asserts the statement in my original affidavit concerning my experience in the game industry is contradicted on page 148 of my deposition transcript (App. 51). The deposition transcript refers to the state of my knowledge in October 1990 whereas my affidavit speaks of the current state of my knowledge of the game business. *See, Id.*

(6) On the same page of its memo Western mischaracterizes the testimony at pages 24-27 of my deposition as saying that I only licensed two game products, *Clever Endeavor* and *Not,* which earned royalties of only $20,000. My experience in the game business was far broader than licensing two

games. *Clever Endeavor* alone earned hundreds of thousands of dollars in royalties. Most importantly, there is no conflict between my deposition and my affidavit.

(7) On page 9 of its memo on the motion to strike Western alleges that ¶ 38 of my affidavit contradicts testimony on page 34 of my deposition in stating MindGames was not formed for the sole purpose of manufacturing *Clever Endeavor*. There is no contradiction. As is clear from further testimony on pages 33 and 34 of my deposition (App. 46-47) I testified that MindGames' business was game and toy development and publishing and was not limited to the manufacturing of *Clever Endeavor*. As ¶ 38 of my affidavit also points out, MindGames' ability to engage in other business activities was impaired by Western's failure to pay the sums required of it under the license agreement.

(8) At page 14 of its summary judgment memorandum Western alleges *Clever Endeavor* experienced limited success because it was one of the more expensive adult board games, citing page 98 of my deposition. Nothing in my deposition, or in any other evidence cited by Western, suggests that *Clever Endeavor's* sales suffered because of the game's price. In fact, *Clever Endeavor* enjoyed an excellent market reception in 1989 notwithstanding its price. In fact, during the term of the Agreement, *Clever Endeavor's* wholesale price was *lower* than and its retail price was about the same as *Pictionary*.

(9) On the same page of its memo Western alleges, "There were other similar board games on the market, including *Anybody's Guess*, which were similar to *Clever Endeavor*," citing pages 423-33 of my deposition. While some had suggested a similarity, I clearly testified at pages 427, 429 and 433 of my deposition (App. 58-60) that neither I nor the head of Games Gang thought *Anybody's Guess* was similar enough to *Clever Endeavor* to be a problem.

(10) On page 14 of its memo Western falsely alleges that I rejected Western's advice to advertise on television in favor of radio, citing pages 361, 369-70, 378 and 386-92 of my deposition and my September 12, 1990 letter to Dave Gillies at Games Gang. I never rejected television advertising and nothing in my deposition or my letter to Gillies substantiates Western's allegation. On the contrary, I testified that the decision to go with radio rather than television was made by Ralph Donnelly of Games Gang. *See*, pages 364, 373 and 391-92 of my deposition (App. 55-57A).

(o) ¶ 9, third sentence. I personally saw the letters of appreciation referred to.

(p) ¶ 11. I personally witnessed that many retailers sold out of *Clever Endeavor* during the 1989 Christmas season. Many retailers reported to MindGames that *Clever Endeavor* was selling quicker than any game they had ever handled, including *Trivial Pursuit*. A videotape showing the responses of several retailers was shown to the court and counsel at the last pretrial hearing. Games Gang televised a

longer version of this tape continuously for at least two days in its showroom at the 1990 Toy Fair.

(q) ¶ 15, fourth sentence. I personally heard these admissions at the 1990 Toy Fair.

(r) ¶ 8. The statements in this paragraph are all based upon my personal observations and knowledge, including representations made to me by Games Gang. Exhibit 3076 (App. 61) is from Games Gang's 1990 Toy Fair catalog in which *Clever Endeavor* is the first game featured. I observed this catalog being used at the 1990 Toy Fair where it was given to buyers. Games Gang discussed *Clever Endeavor* with retailers and sold the game to them at the Toy Fair. This was before the Agreement was signed. Exhibits 2038-41 (App. 2-5) document more than fifty *Clever Endeavor* manufacturing activities engaged in by Western even before the Agreement was signed. It was obvious to me that both Western and Games Gang had firsthand information about the experience with *Clever Endeavor* before they entered into the Agreement.

(s) ¶ 9, first two sentences. I have personal knowledge of the awards referred to which were received by *Clever Endeavor*. In addition, I am personally aware that the *Milwaukee Sentinel* listed *Clever Endeavor* among the "Ten Best Board Games to Show Up in Time for Christmas '89." A 1989 *Chicago Sun Times* review said *Clever Endeavor* may be "the (sic) Cinderella game of the year." *Packet Magazine* included *Clever Endeavor* in its "Top Toys 1989" article, stating "the clues are so cunning that even if you know the answer, it is a temptation to hear the rest of them." The *Chicago Tribune* featured *Clever Endeavor* on the front page of its "Weekly Guide" and listed it among 1989's "Top 25 Games," as did the *Dallas News*. *USA Today* included *Clever Endeavor*

in 1989 in an article describing seven adult games as "playthings to discover." In 1989 the *New York Daily News* said, "*Clever Endeavor*, created by 1,000 people from around the country, is also a hit."

(t) ¶ 19, first sentence. The negotiators for Western and Games Gang made the representations about *Clever Endeavor* having proved itself and being destined for great success to me personally.

(u) ¶ 27. As to subparagraph (a), discovery on this issue is not complete but information supporting it is contained in WP 1790-92 and 1796 (App. 62-65). Further, WP 1563 and 1565 (App. 21 and 22) indicate that while the dollar volume of game sales for the industry went up, sales for Games Gang/Angel dropped 46%. The information in (b) is based upon a combination of my personal knowledge and representations from Games Gang. *See*, Ralph Donnelly's letter of November 8, 1990 referring to massive cancellations. (App. 66). Representations from Games Gang are also the basis for (c). *See also* the Lee Gelber "errata" letter attached at App. 67. Support for the allegation of (d) is found in WP 2131 (showing ad run dates 11/12 through 12/9/90). App. 23. According to billing records, ads ran from November 26 through December 30, 1990. This paragraph is also based upon representations made to me by Games Gang and upon personal knowledge. I have personal knowledge of the matters referred to in subparagraph (e) and various Games Gang personnel provided further information. Discovery is pending with respect to (f). I have personal knowledge of the statement in (g) as well as representations by Games Gang that promised public relations activities were not performed. As to (h), documents provided by Western disclose no advertising expenditures in 1994. Western has admitted spending below the

amounts required for 1993. Spending was also below the required amount in 1990. We do not at this time have sufficient information as to whether the required ad funds were spend in 1991 and 1992. I have personal knowledge of the failure of Western to provide the information referred to in (i). The statements in (j) are based upon my personal knowledge and upon representations made to me by Games Gang and Western.

/s/ G. Lawrence Blackwell, III
G. Lawrence Blackwell, III

Subscribed and Sworn to before me
this 14th day of September, 1996. [SEAL]

/s/ Steven A. Wagner
Notary Public, State of California
My commission 6/13/97.

BROWN & JONES REPORTING, INC.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.,

Plaintiff,

-vs- Case No. 94-C-552

VOLUME I

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

-vs- Case No. 94-C-998

WESTERN PUBLISHING

Defendant.

Examination of GEORGE LAWRENCE BLACKWELL, III, taken at the instance of the Western Publishing Company, Inc., under the and pursuant to the Federal Rules of Civil Procedure, pursuant to stipulation, before LINDA J. SAARI, a Registered Professional Reporter and Notary Public in and for the State of Wisconsin, at Kersten & McKinnon, S.C., 231 West Wisconsin Avenue, Milwaukee, Wisconsin on the 12th day of August, 1995, commencing at 4:45 p.m. and concluding at 8:05 p.m.

* * *

[24] A To start MindGames.

Q For what period of time were you employed by MindGames?

A We incorporated in March of '88 and – would you define "employed" for me?

Q Worked with.

A I continued to work with Mindgames. I have worked with Mindgames from March of '88 until today. I would like to add that in '85 I worked for some time with Culver Summer Naval School for about a seven-week period. So there was that seven-week period that I was in and out with Rooney Pace and with Culver Summer.

Q What did you do during this time?

A Taught sailing.

Q Since March of 1988 have you had any other business employment or business ventures in addition to your involvement with Mindgames?

A Yes, Game Plan was founded in early '91. I don't recall exactly.

Q Is that company still in existence?

A Yes it is.

Q Are you still affiliated with them?

A Yes, I am.

Q Where is Game Plan located?

* * *

[34] development and publishing.

Q Did you have any partners when you created Mindgames?

A No, I did not.

Q Obviously, one of the products of Mindgames is "Clever Endeavor".

A Right. Correct.

Q Are there any other products?

A "Clever Endeavor" was our first and only product.

Q Explain for me why Game Plan was created, which has a similar nature of business to Mindgames.

A Because the three of us wanted to work together, and legally I didn't want to intermingle that in with my Mindgames business.

Q And you testified you were the initial sole shareholder. Who were the other shareholders?

A Banks Blackwell, B-A-N-K-S; Marlyn, M-A-R-L-Y-N, Blackwell, Leigh L-E-I-G-H, Ann A-N-N, Ayres, A-Y-R-E-S, and Len, L-E-N, Blackwell.

Q Are these individuals all family members?

A They are. I need to correct myself. Banks Blackwell and Marlyn Blackwell do not own the stock personally, it is in a trust set up for them.

Q Set up for whom?

A Set up for them.

Q Marlyn Blackwell is your mother?

* * *

[46] A I believe I was answering the question what factors would have an affect on my assessment of whether or not a game is successful.

Q Where did you come to the understanding that these factors affect the assessment of whether or not a game is successful?

A How they affect my understanding of whether or not a game is successful?

MR. KERSTEN: I'm sorry.

BY MS. SLOANE WEITMAN:

Q And my question is where did you – what is the basis for your view that these factors affect your assessment as to whether or not a game is successful?

A My experience in the game industry, as well as just a general background in business.

Q Did you have any experience in the game industry prior to developing "Clever Endeavor"?

A No.

Q And I believe you testified that the only other game that you were involved with that was on the market was "Not", correct?

A That had – it depends on which games that Carol Rehtmeyer brought out that I assisted in developing. I'm

not aware of those that – I'm aware, yes, "Not" was the only other game. I have assisted others from

* * *

[79] A They were paid if the clue was published. And if three – the clues had six statements. If three or more of the six statements were from them, they were paid.

Q How much were they paid?

A $15 for a set of six statements, but they were paid on a statement or a line basis. So they did not necessarily receive $15. Probably broke down to $2.50 per statement.

Q Had you ever come up with a game idea prior to the idea for "Clever Endeavor"?

A Not that was marketed.

Q Did you ever seek to market any games?

A No.

Q When you came up with the idea for "Clever Endeavor", did you have a particular market in mind who you expected to purchase the game?

A It was based on the popular features of "Trivial Pursuit" and "Pictionary", so we had a desire to appeal to a similar market.

Q What market did you understand that to be?

A I would say ages 18 and up.

Q You testified that "Clever Endeavor" was based on the popular features of "Trivial Pursuit" and "Pictionary". What did you mean by that?

[80] A People thought "Trivial Pursuit" was, some of the clues in it were clever, and so we wanted to make this game clever. And also in a lot of ways people used to say to us that they considered this a verbal "Pictionary", and so it was based on some of the popularity of "Pictionary", or I should say it was inspired by. I don't know to what extent it was based on.

Q These were the features that you picked up on in "Trivial Pursuit" and "Pictionary"?

A Correct.

Q So you thought some of the clues in "Trivial Pursuit" were clever, and you thought it was a like a verbal "Pictionary"?

A Correct. And that was reflected back to us.

Q I take it you were familiar with "Trivial Pursuit" and "Pictionary" prior to coming up with your game, right?

A I was familiar with the description of "Pictionary". I had never seen it or played it.

Q Had you played "Trivial Pursuit"?

A Yes, I had.

Q You liked it?

A I liked the features of it.

Q Were you aware of whether or not these games were [81] successful games?

A It was my understanding they were successful, and so it was a natural.

Q What was a natural?

A It was natural to ask the question what about those games made them successful?

Q Did you have discussions with anyone about what features of "Trivial Pursuit" and "Pictionary" made them successful?

A I'm sure some of my friends. I don't recall.

Q Did you have discussions with anybody in the industry or market?

MR. KERSTEN: Excuse me. Could you put some kind of a time frame on that?

MS. SLOANE WEITMAN: Yes, I will. I'm talking about the period of time prior to – let me put it this way. The period of time where the game was being, the concept came to mind and it was being determined, which I believe you understood –

MR. KERSTEN: The gestation period, sort of?

MS. SLOANE WEITMAN: We can certainly use that period. As a mother I'm happy to use it. During the gestation period, so-to-speak. In fact, let's put a time frame on it.

[82] MR. KERSTEN: During the nine months.

BY MS. SLOANE WEITMAN:

Q For what period of time were you involved with basically taking the concept and bringing it to fruition where you actually had a game that was out and being marketed?

A We had samples by February of 1989. We had finished product by September of '89.

Q So when I refer to "the gestation period of the game," I'll use the period of approximately March of 1988 up through the time you had finished product.

Now, during that period of time did you have discussions with anybody in the game industry concerning what features of "Trivial Pursuit" and/or "Pictionary" made them successful games?

A No, we did not.

Q You just had discussion with your friends about this?

A Let me back up. I did have discussions after February of '89.

Q Who did you have discussions with after February of '89?

A Primarily Steve Peek.

Q Was he at that time employed by the – can't pronounce – the manufacturing company in Dallas.

A Yaquinto.

* * *

[84] by "successful"?

A Why do I think they were successful?

Q No, not why they were successful, what I want to get is a definition about what you meant by "successful."

A Why would I deem them to be "successful"?

Q Yes.

A They were the most popular games of their time. That is not my definition of "success," but that is why I deem them successful.

Q What is your definition of "successful"?

A Again, it would be relevant to all the factors we talked about earlier.

Q Let's talk about adult game – let me go back for just a moment. You told me the target age group was 18 and up. Is that what you would agree with me would be an adult game?

A Yes.

Q Did you have any familiarity with the market for adult games in March of '88 when you started coming up with the idea for "Clever Endeavor"?

A Not any more than the average person would in terms of playing games.

Q Did you do any market research during this gestation period of March of '88 up until Toy Fair of '89 on

* * *

[107] A At that point I had not made the determination that we would publish the game.

Q When did you make the determination that you would publish the game?

A Some time in probably spring of 1989.

Q After Toy Fair?

A Right.

Q And that's the period of time when you began getting information about how other games performed?

A No, I probably had that information earlier.

Q Do you recall when you first got that information?

A It was on a continuing basis. I'm sure as early as when I first started getting involved with Mindgames through the time we made that decision. Actually I think the decision to publish the game may have even been as late as summer of '90. I just don't recall at this time. Whenever we placed our manufacturing order, that was when we decided we would publish it.

Q From what sources did you get information about how other games performed?

A Both publicly available sources and magazines, articles, so forth, as well as talking with the inventor.

Q What inventor?

A I think it was the guy who published "USA Trivia".

* * *

[169] A Roughly February of '89 through until the time we shipped, which was September – right, September of '89.

THE WITNESS: I did say '89 in both cases, didn't I?

THE COURT REPORTER: Yes.

BY MS. SLOANE WEITMAN:

Q Now, during this period of time what did you do that you considered to be test marketing?

A We put together a sales force group, a group of manufacturer's reps, and we made direct sales as well as the manufacturer's reps sold the game.

Q Do you recall the volume of the sales during this period?

A We sold roughly 30,000 games by the end of '89. I don't recall what portion we had sold during that period. It was – I just don't recall.

Q Now, the period of time where you sold and distributed the game, what time period was that?

A Well, from the time we shipped.

Q So September of 1989?

A Correct.

Q Through the license agreement?

A Correct.

Q Which was March of 1990?

* * *

[172] arrangement with Games Gang and Western?

A We sold it nationally but just had concentrations. I would say – I don't know. I know we had concentrations in Chicago and Minneapolis. I know we probably had concentrations in ten other areas, not to the extent of those two but concentrations, and I don't really know – I just don't recall the other areas at this point.

Q List for me the various promotional or advertising or marketing techniques that Mindgames used up until the time of its license arrangement with Games Gang and Western.

A Okay. Advertising, we provided co-op advertising to the retailers. We did some radio advertising. I can't recall offhand any other advertising. Promotion wise we tried attending events, having a bar night where a deejay would talk about Clever Endeavor. I think those – some of these things can be effective, but the PR firm did things in such an expensive way that it was rendered in my opinion ineffective. I'm sorry.

Q Were there any other promotional activities that Mindgames engaged in other than attending events and the bar night?

[173] A I'm sure there are.

Q Did you attend trade shows?

A We attended trade shows.

Q Was that something you had put in the category of a promotional activity?

A No.

Q Why not?

A Because that's selling to the trade. Promotional activity is normally considered selling to consumers.

Q There are other promotional activities that you can recall?

A None, no.

Q Turning back to the advertising that Clever Endeavor – excuse me, Mind Games [sic] engaged in prior to the license agreement, you testified that there were some radio ads. Where were the radio ads played?

A Chicago and Minneapolis, St. Paul. Or Minneapolis. I don't know what reach they had in St. Paul.

Q What radio stations in Chicago?

A WGN. One other, geez. It was kind of a top 40 format. I don't remember what the call letters are.

* * *

[192] introducing the game to the market. There was no previous demand for the market. We hadn't developed a lot of demand in advance purposefully, so we weren't missing opportunities. There was no opportunity lost. There was no opportunity to disappoint consumers.

Q When you say you had not created an expectation for the game on purpose, what do you mean?

A Well, there's no point in creating demand for – in my opinion if it's a brand new product which would be different from, say, Windows 95. Everybody understands that Windows 95 is, how it's used, I mean, within context. They understand it's an improved version of Windows 5.1, so there's benefit from Microsoft creating advanced demand. From our standpoint promoting Clever Endeavor is advance when people don't know what it is did not make sense.

Q Now, you testified that Steve Peek contacted Games Gang to take a look at it from a manufacturing standpoint.

A Um-hm.

Q Who at Games Gang did he contact?

A I don't really know. I met with Ralph Donnelly, but whether he contacted Ralph Donnelly I'm not [193] sure.

Q Did you meet with Ralph Donnelly at the 1990 Toy Fair or before that?

A Before. I want to say mid-December of '89.

Q Where did that meeting take place?

A In his office in New York.

Q Was that your first contact with either Western or the Games Gang concerning Clever Endeavor?

A It was my first contact.

Q Who else was at the meeting?

A I believe Mary Mellor was.

Q Anyone else?

A (Witness shakes head.)

Q I'm sorry, you have to answer audibly.

A I'm sorry, I'm thinking. Not that I recall.

Q How long did the meeting last?

A Between an hour, hour and a half, I don't recall.

Q Had you heard of Games Gang prior to your meeting Mr. Donnelly and Mary Mellor?

A Yes, I had.

Q How had you heard of them?

A I knew it was a distributor for Pictionary.

Q How did the meeting get set up? Did Games Gang contact you or did Steve Peek set it up?

A I think Steve Peek set it up.

* * *

BEST AVAILABLE COPY

INCOME ST ENT:
Dimilliums, a
From Bal Fwd to 12/31/07

	INCOME		
5400	Sales - Games	$525,707.23	
5400A	Returned Sales - Games	.00	
5400B	Sales Discounts	(13,256.20)	
5400C	Returned Sales - Damaged	(35.00)	
5404	Payment Discount	.00	
5410	Sales - Other	.00	
0000	Cash Discounts Earned	.00	
8040	Interest Earned	896.02	
8160	Miscellaneous Income	.00	
8160	Bad Debts Collected	.00	
	TOTAL INCOME		$513,314.05
	EXPENSES		
5000	Cost of Goods Sold - Games	$189,078.85	
5010	Cost of Sales - Other	.00	
6420	Shipping Expense	26,815.72	
6430	Handling & Warehouse Expense	8,184.74	
6440	Mishandling Expense	138.39	
7000	Consumer Advertising Expense	25,721.00	
7005	Trade Advertising Expense	16,316.74	
7010	Public Relations Expense	102,309.75	
7015	Demo Expense	14,811.61	
7020	Commission Expense	45,437.10	
7030	Trade Show Expense	38,359.14	
7040	Entertainment Expense	406.13	
7050	Travel Expense	1,747.77	
7060	Lodging Expense	.00	
7070	Telephone 800 Expense	3,619.78	
7100	Collection Expense	.00	
7110	Bad Debts Expense	.00	
7190	Storage Expense	347.49	
7200	Rent Expense	9,000.00	
7210	Utilities - Gas & Electric Exp	.00	
7220	Telephone Non-800 Expense	12,214.49	
7230	Accounting & Bookkeeping Exp.	532.90	
7240	Legal Fees	5,726.70	
50	Office Supplies Expense	4,116.21	
60	Dues & Subscription Expense	920.50	
7270	Bank & Credit Charges	305.80	
7275	Capitalization Expense	2,008.84	
7280	Repairs & Maintenance Expense	.00	
7290	Equipment Rental Expense	.00	

INCOME STATEMENT

[illegible]
From Bgn Fwd to 12/31/07

7300	Miscellaneous Expense	279.95	
7340	Postage Expense	8,642.86	
7360	Solicitation Ads Expense	4,022.04	
7370	Solicitation Printing Expense	4,064.03	
7380	Solicitation Postage Expense	4,742.20	
7390	Solicitation Label Expense	355.00	
7400	Editing Expense	17,237.94	
7405	Club Waiting Payments	767.50	
7410	Photo Copy Expense	1,832.94	
7420	Design & Prototype Expense	4,627.18	
7430	Research & Development	390.33	
7440	Marketing Material Expense	5,162.07	
7445	Marketing Expense - Other	16,105.05	
7450	Marketing Printing Expense	7,140.12	
7460	Marketing Leads	1,565.09	
7470	Marketing Pre-Production Exp.	4,066.09	
7480	Pre-Production Expense	34,588.37	
7490	Sampling Expense	16,533.96	
7500	Salaries - Officers	.00	
7510	Salaries - Administrative	66,164.17	
7520	Contract Labor Expense	3,912.41	
7550	Insurance - Group Medical Exp.	.00	
7560	Ins. Prop. Cas. Liability Exp.	1,216.00	
7600	Organization Costs	.00	
7610	Depreciation - Mach. & Equip.	3,195.89	
7620	Depreciation - Furn. & Fix.	.00	
7630	Depreciation - Other	.00	
7700	Interest Expense	2,623.02	
7810	Taxes - Sales & Excise Expense	.00	
7820	Taxes - Payroll Expense	5,146.64	
7830	Taxes - State Income Expense	.00	
7840	Taxes - Federal Income Expense	.00	
7850	Taxes - Other	154.17	
	TOTAL EXPENSES		$721,536.31
	NET PROFIT (LOSS)		($208,222.24)

[524] UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.,	)	
Plaintiff,	)	
vs.	)	No. 94-C-552
MINDGAMES, INC.,	)	
Defendant.	)	
MINDGAMES, INC.,	)	
Plaintiff,	)	
vs.	)	No. 94-C-998
WESTERN PUBLISHING COMPANY, INC.,	)	
Defendant.	)	

October 17, 1995

9:45 a.m.

The deposition of GEORGE LAWRENCE BLACKWELL, III, resumed pursuant to adjournment at Suite 2700, 333 West Wacher Drive, Chicago, Illinois.

* * *

[600] during this period?

A I knew that they were selling "Clever Endeavor".

Q Did you have any other licensees to sell "Clever Endeavor" from February 1, 1993 through January 31, 1994?

A Not in the U.S.

Q Did you seek any other distributors to sell "Clever Endeavor" in the United States between February 1, 1993 and January 31, 1994?

A I believe I've already answered that.

Q And your answer was no, correct?

MR. KERSTEN: Well, I believe it was.

THE WITNESS: I believe it was. Pardon me. I believe I answered that I did seek or talk to – I'm sorry, I'm a year behind, or ahead, whichever.

BY MS. WEITMAN:

Q Right. I'm talking about the February, 1993 to January 31, 1994 time period.

A I think that is correct.

Q You did not seek other distributors, correct?

A That's my recollection at this time.

Q So it was your understanding that Western was the exclusive licensee to manufacture and distribute "Clever Endeavor" from February 1, 1993 through [601] January 31, 1994, correct?

MR. KERSTEN: Objection. Calls for a legal conclusion. Answer subject to the objection.

THE WITNESS: Not using legal terms, yeah. Yes.

BY MS. WEITMAN:

Q Now, for the period of February, 1993 through January, 1994 –

A I'm sorry, would you give me the dates again?

Q Yes. From the period February, 1993 through the end of January, 1994 –

A Okay.

Q – Western sent MindGames monthly royalty checks, correct?

A As far as I recall, yes.

Q Now, except for the check for January, 1994, which was received in February, 1994, MindGames accepted and cashed the royalty checks received for this period, correct?

A I don't recall.

Q Do you have any recollection of not cashing any of the royalty checks that were sent to you for the period covering February, 1993 through the end of January, 1994?

A No, I have no such recollection at this time. Have

* * *

[304] IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING
COMPANY, INC.,

Plaintiff,

-vs- Case No. 94-C-552

MINDGAMES, INC.,

Defendant.

VOLUME III CONSOLIDATED CASES

MINDGAMES, INC.,

Plaintiff,

-vs- Case No. 94-C-998

WESTERN PUBLISHING
COMPANY, INC.,

Defendant.

The resumed deposition of GEORGE LAWRENCE BLACKWELL, III, called for examination, taken pursuant to the applicable Rules pertaining to the taking of depositions, taken before MARCY REITER, a Notary Public within and for the County of Cook, State of Illinois, and a Certified Shorthand Reporter of said state, CSR No. 84-1890, at Suite 2700, 333 West Wacker Drive, Chicago, Illinois, on the 16th day of October, A.D. 1995, at 10:55 a.m.

* * *

[511] concerned that Western had legal counsel present and you did not?

A. No, I did not.

Q. Did you have any understanding as to –

A. Excuse me, I did not tell any of them at that meeting that I was concerned about that.

Q. Did you have any understanding as to why Dale Gordon was present?

A. At that time, no.

Q. Had you met Dale Gordon previously?

A. Not that I recall. I may have said hello to him earlier in the day. I don't remember. I don't recall having any discussions with him.

Q. After you responded that you wanted to understand Western's entire position before signing the 1993 letter agreement, what did Western say?

A. John Pohl – some how the conversation got on to whether or not they wanted to license the game for '94 or the year beginning February 1st, 1994.

John Pohl said he had talked to his salespeople and he was not confident that they would sell enough games, that they would – or they [512] could justify paying a minimum royalty of – a minimum advanced royalty of 27,500.

Q. Did Mr. –

A. I'm sorry. And therefore it did not make sense for them to do that.

Q. When you say "to do that," what do you mean?

A. Meaning commit to an advanced minimum royalty of 27,500 for that year.

Q. Was there any discussion about the $300,000 royalty figure?

A. No, there was not.

Q. When Mr. Pohl made these comments, how did you – did anybody else from Western say anything else?

A. Not that I recall.

Q. How did you respond?

A. Well, I responded by telling him that I was there to discuss a two-year extension if they had an interest and was asking for advanced minimum royalty of $55,000, but obviously that was a moot point since they didn't think they could justify the twenty-seven five for the one year.

[513] Q. How did Western respond?

A. They agreed.

Q. What else was discussed? I didn't mean to cut you off. Did you have more of your answer?

A. No, that's fine.

Well, they agreed that it was a moot point.

Q. Was anything else discussed in the meeting?

A. Dale Gordon said they were prepared to offer the games, their inventory of Clever Endeavor games at their manufacturing cost. They thought, they weren't absolutely sure.

Q. Offer them to you?

A. Correct.

Q. How did you respond?

A. I asked how many games they were talking about and asked what their manufacturing price was or manufacturing cost. I should say.

Q. How did Western respond to that?

A. They weren't really sure what their manufacturing cost was and there was some discussion about it, but their best estimate was 4.50 to 4.75 a game, and I think they told me their

* * *

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Appeal No. 98-1879

WESTERN PUBLISHING COMPANY, INC.,

Plaintiff-Appellee,

v. No. 94-C-552

MINDGAMES, INC.,

Defendant-Appellant.

MINDGAMES, INC.,

Plaintiff-Appellant,

v. No. 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant-Appellee.

Appeal from the United States District Court
for the Eastern District of Wisconsin,
The Honorable Robert W. Warren followed by
The Honorable Lynn S. Adelman, Presiding

BRIEF OF APPELLEE WESTERN PUBLISHING COMPANY, INC.

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Dated: February 22, 1999

difficulty in determining the amount of lost profits precluded franchisor's recovery of damages for lost future royalties).[6]

E. The Fact That *Clever Endeavor* Had No History Of Profits and That *Clever Endeavor* Is An Entertainment Product Further Supports The Dismissal of MindGames' Lost Profits Claim.

1. *Even in jurisdictions rejecting the New Business Rule, lost profits are precluded where there is no history of profits.*

Even if the Court were to reject a strict application of the New Business Rule, this Court should affirm the dismissal of MindGames' lost profits claim because MindGames has no history of past profits. It is undisputed that MindGames will not be able to introduce evidence of its profits prior to the alleged breach of the License committed by Western – MindGames failed to achieve *any* profit in 1988 or 1989. (App. 118-121.) Without any evidence of past profits, anticipated profits

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[6] MindGames' attempt to analogize the undisputed facts here with the farmer who leases drilling rights to Standard Oil demonstrates the absurdity of its argument. (MindGames Br. 21.) A new, unique adult board game, unlike oil, has no preexisting market value. MindGames' analogy is similar to the fact pattern in *Milex*, where the products' fungability made the New Business Rule inapplicable. MindGames' claim for lost profits is more analogous to a movie screenwriter suing MGM for lost profits because his screenplay was not as successful as MGM's most recent blockbuster.

generally are precluded as a matter of law, regardless of whether the damaged party is a new business. Without such evidence of past profits, MindGames has no reliable basis to demonstrate its alleged lost profits with any reasonable certainty. *See Rich v. Eastman Kodak Company*, 583 F.2d 435, 437 (8th Cir. 1978) (no recovery for anticipated profits because plaintiff was not profitable before problems developed with the product); *Empire Shoe Company v. Nico Industries, Inc.*, 197 Ga. App. 411, 414, 398 S.E.2d 440, 443 (1990) (granting defendant summary judgment dismissing plaintiff's lost profits claim because plaintiff could not produce any evidence regarding past net profits).

2. *The success of a new product in the entertainment industry is especially difficult to predict.*

If the Court were to question whether the Arkansas Supreme Court would retreat from its across-the-board application of the New Business Rule, there can be no doubt that this is not the circumstance where Arkansas courts would begin to do so. As Judge Warren noted, it is particularly appropriate to apply the New Business Rule in the entertainment/consumer product industry. (App. 7-8.) In this field, the chances of success are next to impossible to predict because an entertainment product, such as an adult board game, is subject to the most subjective and unpredictable critic – the public.

When confronted with a claim for lost profits in the entertainment industry, other courts have recognized the

inherently speculative nature of such a damage claim.[7] For example, in *Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410 (8th Cir. 1995), a wine marketer ("Hillside") brought a breach of contract action after the manufacturer ("Carlisle") failed to manufacture the required number of Hillside's new product – disposable plastic wine glasses with fliptop lids. Hillside alleged that it could not fill its first, and only, large order for 30,000 glasses, and that its

* * *

[7] As a result of the unpredictable nature of the entertainment industry, parties similarly situated to MindGames have failed to recover the alleged lost profits of their new businesses. *See, e.g., Handi Caddy, Inc. v. American Home Products Corp.*, 557 F.2d 136 (8th Cir. 1977) (in breach of contract action against distributor for failing to advertise plaintiff's new product on pizza packaging, court reversed jury's award of damages to plaintiff for alleged lost profits because evidence of lost sales too speculative); *Murray, etc. et. al. v. Hadid, et. al.*, 238 Va. 722, 385 S.E.2d 898 (1989) (affirming trial court's decision to set aside jury's award of lost profits because evidence of new enterprise's lost profits depended upon too many contingencies to safeguard an estimate of damages). *Proteus Books Ltd. v. Cherry Lane Music Co.*, 873 F.2d 502, 510 (2nd Cir. 1989) (affirming district court's vacating of a jury award for lost profits because, *inter alia*, inherent uncertainties of predicting profits in the entertainment industry made prospective sales of book publisher difficult, if not impossible, to calculate).

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING
COMPANY, INC.,

Plaintiff,

v. Case No. 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

v. Case No. 94-C-998

WESTERN PUBLISHING
COMPANY, INC.,

Defendant.

MEMORANDUM OF MINDGAMES, INC., IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT OF WESTERN PUBLISHING COMPANY, INC.

INTRODUCTION AND SUMMARY

The motion of Western Publishing Company, Inc. ("Western") for summary judgment must be denied because it is based on a false analysis of the nature of one of MindGames' damage claims and a misapplication of the "new business rule."

Western asserts that MindGames, as a "new business," is not entitled to seek damages for loss of future profits because the "new business rule," which Western believes applies, precludes such a claim.

Western's motion has no merit. The "new business rule" does not apply because neither Western nor its co-licensee, Games Gang, Ltd. ("Games Gang"), which had full responsibility for the manufacture and sale of *Clever Endeavor*, was a new business and because MindGames does not seek damages for lost profits. The damage claim at issue on this motion is for lost royalties, not lost profits. Under ¶ 4 of the license agreement (App. 28)[1] MindGames was to receive a base royalty of 13.5% of net sales on the first 300,000 units of *Clever Endeavor* and 15% on all net sales over 300,000 units. "Net sales" is defined in ¶ 4 to mean gross invoiced sales price less specified invoice allowances, taxes, returns and bad debts. The profitability of MindGames, Western and Games Gang does not affect the royalty payments in any way.

Even if this were the kind of case to which the "new business rule" might apply, and Arkansas court would not apply it and neither should this court.

It is important to keep the point of Western's summary judgment motion in sharp focus. It is that the new business rule prevents MindGames from proving "lost profits" as a matter of law. Western argues, in other word, that Arkansas law does not allow MindGames even to

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[1] "App." references are to the appendix to the accompanying affidavit of G. Lawrence Blackwell, III. "Aff." means the Blackwell affidavit itself.

attempt to prove the fact and/or the amount of its damage simply because MindGames itself is a new business.

Western spends considerable effort (Br. at 9-12, 16-17) attempting to show that MindGames is a new business and had no history of profits. Assuming *arguendo* that is true, it has no relevance whatever to MindGames' damage claims. As a licensor, MindGames' royalty income depended on the efforts of the licensees, Western and Games Gang, neither of which was a new business. On the contrary, they had long experience and great success in the licensing, making and selling of games. Western held itself out as the second largest player in the game business. *See*, Aff. ¶ 13. Games Gang had been largely responsible for two very successful adult games: *Trivial Pursuit*, which had earned its inventors $75 million or more in royalties, and *Pictionary*, which had brought its inventors $30 million or more by the time MindGames licensed *Clever Endeavor*. Western and Game Gang were co-licensees of *Pictionary*.

Clever Endeavor was not a "new product" in any relevant sense. By the time of the license agreement it had been on the market for about a year and had enjoyed a high degree of success during the seven months MindGames was shipping it, especially considering the limited manufacturing and marketing capability of MindGames at the time. Then *Clever Endeavor* was licensed to Western and Games Gang in March 1990 and continuing until June 1994, a period of over four years. The damage claim at issue on this motion alleges lost royalties over the entire period of the license.

Under the applicable law cited later in this brief it is MindGames' obligation to prove its damages to a reasonable certainty. MindGames acknowledges its obligation to establish its claims by appropriate evidence beyond the boundary of speculation and guesswork and looks forward to the opportunity to do so. Meanwhile, Western has not proposed a single fact or offered any evidence beyond the mere unsupported opinions of its lawyers establishing that, as a matter of law, MindGames will be unable to fulfill its burden. On this motion we are not arguing the sufficiency proof, but whether MindGames has the right to present proof. Clearly it has the right, which requires denial of the motion for summary judgment.

STATEMENT OF FACTS

The facts that should be considered on this motion are set forth in ¶¶ 1 through 35 of the accompanying affidavit of G. Lawrence Blackwell, III. Rather than substantially repeat them here, the reader is invited to read that part of the affidavit at this point.

Regarding facts contained in Western's brief, we are obliged to point out that Western's citations to Mr. Blackwell's deposition sometimes do not support the statements they are offered to prove, as follows:

Page of Brief	Reference to LB Deposition	Incorrect Characterization
3	24	That Blackwell formed MindGames solely to develop *Clever Endeavor*
3	79-81	That Blackwell believed *Clever Endeavor* would achieve the same success as *Pictionary* and *Trivial Pursuit*
3	82	That when he formed his belief about the potential of *Clever Endeavor* he had not discussed success features of *Pictionary* and *Trivial Pursuit* with industry people
4	160-65	That all focus group testing was among friends or relatives or only at their homes
4	172	That prelicense marketing of *Clever Endeavor* was limited to event promotions, radio ads and co-op advertising
4	174-75	That MindGames did not use TV ads only because the cost was not justified
4	169	That MindGames had no profit for the year 1989 despite selling 30,000 games

MINDGAMES' RESPONSE TO FINDINGS OF FACT PROPOSED BY WESTERN

MindGames disagrees with findings of fact 2 through 16 proposed by Western. The specific disputes and the evidentiary materials which support the claim that a dispute exists are set forth in ¶¶ 36 through 49 of the Blackwell affidavit, which are incorporated by reference here.

PROPOSED FINDINGS OF FACT OF MINDGAMES, INC.

Pursuant to Local Rule 6.05(b) (2), MindGames proposes the following factual propositions which it deems to be relevant to the motion for summary judgment.

1. At the time MindGames licensed *Clever Endeavor*, the Games Gang, Ltd. ("Games Gang") was a well-established, experienced and successful marketer of adult board games and other products. Aff. ¶ 15.

2. At the times MindGames licensed *Clever Endeavor*, Western Publishing Company, Inc. ("Western") was a well-established, experienced and successful manufacturer and marketer of adult board games and other products. Aff. ¶¶ 12-13.

3. Prior to obtaining the *Clever Endeavor* license Games Gang and Western had been co-licensees for a successful adult game known as *Pictionary*. Aff. ¶¶ 12, 15.

4. The licensor(s) of *Pictionary* had received royalties in excess of $30 million by the time *Clever Endeavor* was licensed in March 1990. Aff. ¶ 18.

5. At the time *Clever Endeavor* was licensed in March 1990 Western was aware that the licensors of *Trivial Pursuit* had received royalties on that game that probably exceeded $75 million. Aff. ¶ 18.

6. The royalties payable to MindGames under the *Clever Endeavor* license agreement were unaffected by and unrelated to the profitability or unprofitability of the business operations of MindGames prior to the effective date of the license. Aff. ¶ 23.

7. The royalties payable to MindGames under the *Clever Endeavor* license agreement were unaffected by and unrelated to the profitability or unprofitability of the business operations of MindGames following the effective date of the license. Aff. ¶ 23.

8. The royalties payable to MindGames under the *Clever Endeavor* license agreement were unaffected by and unrelated to the length of time MindGames was in business prior to the license agreement. Aff. ¶ 23.

9. The royalties payable to MindGames under the *Clever Endeavor* license agreement were unaffected by and unrelated to the length of time MindGames was in business after the effective date of the license agreement. Aff. ¶ 23.

10. Western was a licensee of a board game known as *Balderdash*. Aff. ¶ 20.

11. Western agreed to pay royalties to the licensor(s) of *Balderdash* of 15% of sales as defined in the *Balderdash* license agreement. Aff. ¶ 19.

12. Western paid royalties to the licensor(s) of *Pictionary* of 15% of sales as defined in the *Pictionary* license agreement. Aff. ¶ 19.

ARGUMENT

I. LEGAL STANDARDS ON MOTION FOR SUMMARY JUDGMENT

Western's brief (at 7) correctly states the legal standards to be applied by the court on a motion for summary judgment under Fed. R. Civ. P. 56(c): (1) Summary may not be granted unless there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law; (2) The moving party has the burden to prove there is no genuine issue of material fact – *Donovan v. City of Milwaukee*, 845 F. Supp. 1312, 1313 (E.D. Wis. 1992); (3) The Court must view the record in the light most favorable to the nonmoving party and must draw all inferences in favor of that party – *Kendrick v. East Delavan Baptist Church*, 886 F. Supp. 1465, 1471 (E.D. Wis. 1995); *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

II. THE NEW BUSINESS RULE DOES NOT APPLY TO THIS KIND OF CASE. EVEN IF IT DID, AN ARKANSAS COURT WOULD NOT APPLY IT.

Western seeks to bar a significant element of MindGames' damages by invoking an outdated and disappearing doctrine known as the "new business rule." Under that rule a business which has no operating history can never recover loss of profits because they are supposedly

speculative and incapable of being determined with the necessary degree of certainty. *See,* generally 1 Dunn, *Recovery of Damages for Lost Profits* (4th ed.) § 4.1 (1992). Dunn describes this as the "older rule" followed by "a diminishing number of states." *Id.* at 277. Under the "modern rule." says Dunn (*id.* § 4.2 at 280), a new business may recover such damages as it can prove with reasonable certainty, stating:

> Most recent cases reject the once generally accepted rule that lost profits damages for a new business are not recoverable. The development of the law has been to find damages for lost profits of an unestablished business recoverable when they can be adequately proved with reasonable certainty. The earlier cases are either ignored or rationalized as having been based on a finding that on those particular facts the evidence was inadequate as a matter of law to support a judgment for the plaintiff. What was once a rule of law has been converted into a rule of evidence.

Western relies on *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924), a case decided long before anyone connected with this litigation was born. No Arkansas case has applied the new business rule before or since. In *Marvell* the defendant's counterclaim sought lost profit damages for the late delivery of ice-making machinery. Defendant did not allege any prior involvement in the ice-making business. The court held (at 741) the counterclaim stated no cause of action because it failed to allege or permit an inference the manufacture and sale of ice by the defendant was an "established business." The court said (at 741), "The

anticipated profits of a new business are too remote, speculative and uncertain to support a judgment for their loss."

Citing no authority, Western asserts (Br. at 2) that Arkansas applies the new business rule to "prevent the recovery of any lost profits for a new product, such as *Clever Endeavor*." Western cites and we can find no Arkansas case that applies the new business rule to new products sold by established businesses, such as Western and Games Gang. With some exceptions, "new business rule" states do not apply the rule to new products. *See, John D. Copanos & Sons v. McDade Rigging & Steel Erection Co.*, 403 A.2d 402, 405 (Md. App. 1979) (lost profit claim allowed on lost orders for new drug); *Care Travel Co. v. Panamerican World Airways, Inc.*, 944 F.2d 983 (2d Cir. 1991) (New York law) (lost profits allowed for new travel agency formed by experienced persons); *Milex Products, Inc. v. Alra Laboratories, Inc.*, 603 N.E.2d 1226 (Ill. App. 1992), *app. den.*, 611 N.E.2d 515 (1993) (lost profits allowed for new prescription drug from established drug distributor).

In *Milex Products* the court quoted with approval from *Schatz v. Abbott Laboratories, Inc.*, 281 N.E.2d 323 (Ill. 1972):

> All the law requires in cases of this character is that the evidence shall with a fair degree of probability tend to establish a basis for the assessment of damages.

Like virtually all new business rule cases, *Marvell*, the old Arkansas case, involved a new enterprise claiming loss of profits from its own business operations as a result

of a contract breach or tort by another party. (MindGames does not at this time assert a claim for damage caused to its business operations by being deprived of royalty income on *Clever Endeavor*.) Such cases also involve loss of *profits*, not loss of pure *revenue*.

> A profit is the net pecuniary gain from a transaction. The profit to be made from a contract by one of the parties thereto is the full value of the performance promised him by the other party, *diminished by the cost of his own performance that he contracts to render in exchange.*

5 Corbin *On Contracts* § 1022 at 135-36 (emphasis supplied).

The emphasized language shows why the new business rule cannot apply here: There is no "profit" issue. MindGames had no cost of its own performance. Its performance was complete upon executing the patent license agreement. From there on, the manufacturing, warehousing, shipping, promotion, marketing and sale of *Clever Endeavor* were the obligation of Western and Games Gang. MindGames was to receive royalties on all sales whether or not it was "profitable" in its other business operations and whether or not Western and Games Gang made profits. We are aware of no case that applies the new business rule to the breach of contract to pay royalties.

In any event, it is very unlikely Arkansas would apply the new business rule today. 1 Dunn, § 4.2 at 282, after citing numerous cases which have rejected the new business rule, states:

> The commentators have also recognized that the new business rule is passing away and that recovery of lost profits damages of a new business proven with reasonable certainty is now the majority rule.

The new business rule is also rejected in favor of the modern rule by 5 Corbin *On Contracts* § 1020 at 124 and RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt.b (1981).

Were this court to determine that the facts of this case could bring it within the new business rule, it would be faced with the same situation recently faced by the Third Circuit: What to do about an obsolete state rule that has not yet been abrogated by the state itself. *In re Merritt Logan, Inc.*, 901 F.2d 349 (3d Cir. 1990), involved a claim for lost profits. New Jersey law applied and the defendants relied on the new business rule "embodied in several old New Jersey cases." *Id.* at 356. The court first held that even the brief one-and-one-half-year operating period of the supermarket involved was enough to permit a projection for lost profits (*id.* at 356), noting that even if the store lost money and had no profits, it could still recover lost profits if it could show it would have earned them but for the defendants. *Id.* n.4. More important, the court rejected the new business rule, holding (at 357):

> Moreover, we believe New Jersey would no longer follow a *per se* rule precluding all new businesses from recovering any damages for lost profits. The New Jersey cases that initially set forth the new business rule are more than fifty years old and the New Jersey Supreme Court has not had recent occasion to consider the rule. Accordingly, we must predict whether the

> New Jersey [sic] would follow the rule against giving a new business damages for lost profits if it were now presented with that issue in the context of this case. (Citations omitted).

The court noted the liberal approach to damages taken by more recent New Jersey decisions (as have more recent Arkansas cases – see below), cited Dunn, the Restatement and other authorities and concluded (at 358):

> These authorities lead us to believe that the New Jersey Supreme Court, a court that has been in the forefront of the development of the common law and its adaptation to modern conditions, would no longer treat the new business rule as a *per se* rule. We believe that court would be persuaded by the overwhelming recent authorities holding that damages for lost profits are recoverable if proven with reasonable certainty. Therefore, Merritt Logan was not precluded from recovering lost profits as a matter of law.

The rulings and reasoning in their recent damage cases show Arkansas courts have moved a long way since 1924 in liberalizing the proof of damages. As early as 1932 the only Arkansas case to cite *Marvell* seems to depart from it. *555 Incorporated v. Leming*, 45 S.W.2d 20 (Ark. 1932), held:

> . . . [B]efore recovery may be had for prospective profits the evidence should be such as to establish the amount of profits expected with a reasonable degree of certainty, and a mere estimate that so much profit would have been made, without facts shown upon which that estimate is based, is not sufficient (citing *Marvell*).

This seems to make the issue one of sufficiency of evidence (*i.e.*, the "modern rule"), although the business involved there was not a start-up business.

One of the more illuminating examples of the approach Arkansas courts now take to damages is *Jim Halsey Co., Inc. v. Bonar*, 683 S.W.2d 898 (Ark. 1985), in which a concert promoter sued a booking agent for lost future profits when the artist failed to appear for a benefit concert. Plaintiff was allowed to proceed on both breach of contract and tort (fraud and negligence) theories and was allowed to recover lost future profits on this concert as well as on future concerts he would be unable to promote due to damaged reputation. At 903 the court recited a rule familiar to courts sitting in Wisconsin:

> The rule that damages which are uncertain or contingent cannot be recovered does not apply to uncertainty as to the value of the benefits to be derived from performance, but to uncertainty as to whether any benefit would be derived at all. If it is reasonably certain that profits would have resulted had the contract been carried out, then the complaining party is entitled to recover.

Such a rule is incompatible with the procrustean, 72-year-old rule relied on by Western here.

In *Tremco, Inc. v. Valley Aluminum Products Corp.*, 831 S.W.2d 156, 158 (Ark. App. 1992), the plaintiff was allowed damages for lost profits on future contracts plaintiff could not obtain due to defendant's breach of warranty on a current contract. The court reiterated that the "amount" of lost future profits can be proved with less certainty than the "fact" of such loss, stating (at 158),

"Loss may be determined in any manner which is reasonable under the circumstances."

In *First Service Corp. v. Schumacher*, 702 S.W.2d 412 (Ark. App. 1985), a developer/borrower sought loss of future profits in homes to be built "on spec" where the lender breached an agreement to finance. *Id.* at 413. The court held there must be proof to "reasonable certainty" that future profits would have been made but that once the "fact" of profits is removed from the realm of speculation and conjecture an approximation of the amount of damages is satisfactory. *Id.* at 414. No court taking this approach to damages for inability to build a speculative residence would apply the new business rule to a new "product," if it would apply the rule at all.

In *Union Nat. Bank of Little Rock v. Mosbacher*, 933 F.2d 1440 (8th Cir. 1991), *cert. den.*, 502 U.S. 1031 (1992), decided under Arkansas law, the plaintiff had a recent history of losses. Lost future profits were nevertheless recoverable where the fact of probable profits was established with reasonable certainty. "What must be certain . . . is not a precise calculation of lost profits, but whether profits would have been made." *Id.* at 1444.

Over the life of the license agreement and its extensions MindGames received royalty payments exceeding $500,000. Aff. ¶ 29. It is thus not subject to dispute that MindGames did in fact have "profits," more accurately, royalty payments. This is not uncertain, conjectural or speculative in the least. The issue is, what additional royalty payments would MindGames probably have

received if Western and Games Gang had fully and competently performed their obligations under the license agreement.

Michigan abandoned the new business rule in *Fera v. Village Plaza, Inc.*, 242 N.W.2d 372, 374, 376 (Mich. 1976). The Michigan court added an important corollary that applies in this case (at 376):

> "[W]here injury to some degree is found, we do not preclude recovery for lack of precise proof. We do the best we can with what we have. We do not 'in the assessment of damages, require a mathematical precision in situations of injury where, from the very nature of the circumstances precision is unattainable.' *Particularly is this true where it is defendant's own act or neglect that has cause the imprecision.*" *Godwin v. Ace Iron & Metal Co.*, 376 Mich. 360, 368, 137 N.W.2d 151, 156 (1965) (emphasis supplied).

MindGames is entitled to the benefit of the doctrine embodied in the foregoing emphasized language because any inability to determine with exactness the amount of lost royalties is caused precisely by the failure of Western and Games Gang to perform under the contract.

Some of the non-Arkansas new business rule cases cited in Western's brief are distinguishable or questionable.

Stuart Park Associates Limited Partnership v. Ameritech Pension Trust, 51 F.3d 1319 (7th cir. 1995), purports to be based on Illinois law, tracing back to *Hill v. Brown*, 520 N.E.2d 1038 (Ill. App. 1988), and *Drs. Selke & Conlon, Ltd. v. Twin Oaks Realty, Inc.*, 491 N.E.2d 912 (Ill. App. 1986). Yet *Milex Products v. Alra Laboratories*, 603 N.E.2d 1226,

1237 (Ill. App. 1992), rejected the argument that *Drs. Selke & Conlon, Ltd.*, prevents a new business from ever proving lost profits in favor of what sounds like the "modern rule": A new business can recover lost profits if proven to a reasonable certainty.

Center Ridge Ganley, Inc. v. Stinn, 594 N.E.2d 1064 (Ohio 1991), which relies on two unreported cases, is not good law because Ohio threw out the new business rule in *AGF v. Great Lake Heating Treating Co.*, 555 N.E.2d 634, 638-39 (Ohio 1990), stating:

> Therefore, we adopt the position taken under the Restatement of Contracts 2d, section 352, Comment b, and expressly recognize that a new business may recover lost profits, so long as the buyer provides a sufficient quantum of proof.

McBrayer v. Teckla, Inc., 496 F.2d 122, 123 (5th Cir. 1974), denied recovery of anticipated profits for an *unestablished business*. Western and Games Gang, which were generating royalties for MindGames, were well-established.

Delahanty v. First Pennsylvania Bank, N.A., 464 A.2d 1243 (Pa. 1983), allowed proof of lost profits, even though Pennsylvania is supposedly a new business rule state, if there is evidence of significant interest in the product or service. It cannot be disputed there was significant interest in *Clever Endeavor*. MindGames sole [sic] over 30,000 units in the months before the license agreement. Through June 1994 Western and Games Gang sold over 300,000 units.

III. THE FACT THAT *CLEVER ENDEAVOR* DOES MEAN THAT, AS A MATTER OF LAW, LOSS OF ROYALTIES CANNOT BE PROVED TO A REASONABLE CERTAINTY.

Western argues (Br. at 12-16), in effect, that no matter how badly it botched the handling of *Clever Endeavor*, no matter how egregious its failures under the contract, MindGames cannot claim damages for lost royalties because "entertainment products" are too speculative. Western relies on two inapposite New York cases while ignoring an Arkansas entertainment case that does allow lost profits to patently new ventures: *Jim Halsey Co., Inc. v. Bonar*, the concert promoter case discussed at page 12 above. It also offers the pure opinions and speculations of counsel but not a shred of evidentiary support for its argument.

As to the New York cases, *Proteus Books, Ltd. v. Cherry Lane Music Co.*, 873 F.2d 502, 510 (2d Cir. 1989), does not rule out damages for lost profits for breach of contract to distribute film and music books as a matter of law. Recovery was denied simply because the evidence in the case was insufficient. The court suggested, however, that such a claim would be allowed if the evidence and instructions "leave no room for wild speculation." The plaintiff in *Proteus* was at least given an opportunity to attempt to prove its case. Western asks the court to deny that opportunity to MindGames.

Kenford Co. v. County of Erie, 493 N.E.2d 234, 235-36 (N.Y. 1986), involved a claim for lost profits for breach of contract under which plaintiff was to build a domed stadium. The court deemed a claim for profits over the

twenty-year life of such a stadium too speculative and that the plaintiff's projections were based on too many unknowns and assumptions regarding successful sporting events. However, the court did not rule out plaintiff's attempt to prove its case on the basis of the new business rule. *Id.* at 235. That plaintiff too was afforded the opportunity to attempt to prove its case.

Western suggests a variety of factors that can affect the success of a product in the entertainment field, such as the product's play value, the state of the economy, cost, etc. There is no way any court could evaluate these factors on a summary judgment especially where, as here, Western simply lays them on the table and offers no evidence whatsoever as to how they affected *Clever Endeavor*. Certainly economic conditions can have an impact, yet *Monopoly*, the most successful board game of all time, was introduced in the heart of the Depression. In its 1991 Annual Statement Western boasted that its games, including *Clever Endeavor*, were succeeding despite an economic downturn. *See*, App. 18. The cost of the product can be a factor, yet *Trivial Pursuit* was a smash hit despite its high cost.

Western ludicrously argues (Br. at 13) that Mr. Blackwell's comments on the hazards of the game business and the positive comments about *Clever Endeavor* in his business school applications are somehow inconsistent with his position in this case or somehow reflect on his credibility. Western does not get the point of Mr. Blackwell's comments. Take, for example, the quote from the Perry article appearing on page 13 of Western's brief to the effect that out of every 1,000 games invented only five make it to the shelf and only one or two get to a second

year. Western overlooks that *Clever Endeavor* got past these hurdles. It did make it to the shelf and it lasted more than two years. These achievements bring the success of *Clever Endeavor* out of the realm of speculation. Mr. Blackwell was quite right in pointing out that his invention made it to market despite the pitfalls and enjoyed considerable success within the limited context in which MindGames could operate before the license agreement.

Clever Endeavor enjoyed only limited success under the license agreement, not anywhere near the success it should have had and would have had if Western and Games Gang had properly and competently performed under the contract. That is what this case is about. The high promise of *Clever Endeavor's* first year was aborted by the disarray at Games Gang during at [sic] critical times and the poor handling of the game by both Games Gang and Western as detailed in ¶¶ 26 and 27 of Mr. Blackwell's affidavit.

Western also cites *Handi Caddy, Inc. v. American Home Products Corp.*, 557 F.2d 136, 139 (8th Cir. 1977), in support of its argument that MindGames should be barred from attempting to prove lost "profits." We read that case to stand for the opposite. The court said that a new business may recover lost profits for breach of contract, stating, "In the final analysis, the question is primarily a problem of proof. Each case must rest upon the evidence adduced and it is for the trial judge in the first instance to determine whether the complaining party has produced the quantum and quality of evidence sufficient to submit the issue to a jury." Western does not want this court to hear the evidence.

CONCLUSION

Western's motion for summary judgment should be denied because there are disputed issues of material fact and because Western is not entitled to judgment as a matter of law. The only ground proposed for the motion is that one of MindGames' damage claims should be disallowed because, as a new business, MindGames cannot claim lost profits. Because MindGames was entitled to royalties regardless of its profits or those of its licensees and regardless of the length of time it had been in business and because it is seeking royalties, not profits, this is simply not a "new business rule" case. Even if it were, an Arkansas court would not invoke a solitary 72 year-old-year case to deny MindGames an opportunity to prove its case for lost royalties to the finders of fact.

It is a tribute to the merit and inherent value of *Clever Endeavor* that it achieved a measure of success despite the contract breaches by Western and Games Gang. The real issue is, would *Clever Endeavor* have done better if Western the [sic] licensees had performed as they should have? MindGames should be allowed to offer proof that it would have done better; that whether or not the vagaries of public taste played a role, the misconduct of Western and Games Gang played a substantial and decisive role in depressing the sales of *Clever Endeavor*, thereby depriving MindGames of substantial royalties.

Respectfully submitted,

/s/ E. Campion Kersten
E. Campion Kersten,
Attorney for MindGames, Inc.

CERTIFICATE OF COMPLIANCE

I hereby certify that this memorandum of Mind-Games, Inc., in opposition to the motion for summary judgment of Western Publishing Company, Inc., conforms to the rules for a brief produced with a monospaced font. This brief is 20 pages long and contains 4,970 words.

/s/ E. Campion Kersten
E. Campion Kersten

CERTIFICATE OF SERVICE

I certify that on July 5, 1995, copies of the foregoing memorandum and supporting affidavit in opposition to the motion for summary judgment of Western Publishing Company, Inc., were served by first class mail upon Wendi Sloane Weitman at her address of record.

/s/ E. Campion Kersten
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April 25, 1995

VIA TELECOPIER: 312/984-3150

Richard A. Saldinger, Esquire
Wendi Sloane Weitman, Esquire
Barack, Ferrazzano, Kirschbaum & Perlman
333 West Wacker Drive, Suite 2700
Chicago, Illinois 60606

Re: Western Publishing Company, Inc. v. Mind-Garmes, Inc.; Case No. 94 C 552 MindGames, Inc. v. Western Publishing Company, Inc.; Case No. 94 C 998

Dear Ms. Weitman and Mr. Saldinger:

I agree we should examine settlement prospects. I apologize for not getting back to you sooner in response to your initiative.

We are litigating the consequences of the destruction of a game that was seen by your clients and mine as "the next Trivial Pursuit" or "the next Pictionary." Clever Endeavor's enormous potential was reflected in a license agreement, the terms of which matched those for Trivial Pursuit and Pictionary. We think we can prove that negligence in the manufacturing process and grossly inadequate marketing and distribution substantially vitiated Clever Endeavor's potential. The opportunity to turn the product around was destroyed last June when, without authority, Western liquidated its remaining inventory of 61,000 games for a small fraction of their value.

Pictionary and Trivial Pursuit brought their inventors royalties of approximately $30 million and $60 million respectively. Western's mishandling of Clever Endeavor probably cost MindGames something in this range – say $40 million. There are other specific damage elements included within the overall loss, such as the royalties due on the 61,000 games sold last June, the balance of the royalties due for the period March 1990 through January 1993 and the balance of royalties payable upon the constructive renewal of the license agreement starting February 1, 1994.

We are mindful of the defenses Western alleges and are confident we can deal with them.

We see the target damage potential of this case at approximately $40 million, less royalties actually received. We will consid r settlement at a lower figure in the interest of resolving the case now. What we need to know is how close your clients are willing to come to the target.

Very truly yours,

KERSTEN & McKINNON, S.C.

/s/ E. Campion Kersten
E. Campion Kersten

ECK/mss

cc: Mr. Larry Blackwell

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Appeal No. 98-1879

WESTERN PUBLISHING
COMPANY, INC.,

Plaintiff-Appellee,

v. No. 94-C-552

MINDGAMES, INC.,

Defendant-Appellant,

MINDGAMES, INC.,

Plaintiff-Appellant,

v. No. 94-C-998

WESTERN PUBLISHING
COMPANY, INC.,

Defendant-Appellee.

Appeal from the United States District Court
for the Eastern District of Wisconsin,
The Honorable Robert W. Warren, followed by
The Honorable Lynn S. Adelman, Presiding

BRIEF AND SHORT APPENDIX OF THE APPELLANT

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* * *

It is very unlikely Arkansas would apply the New Business Rule today. 1 Dunn, RECOVERY OF DAMAGES FOR LOST PROFITS (5th ed.) § 4.3 (1998) at 348, after citing numerous cases which have rejected the new business rule, states:

> The commentators have also recognized that the new business rule is passing away and that recovery of lost profits damages of a new business proven with reasonable certainty is now the majority rule.

The new business rule is also rejected in favor of the modern rule by 5 Corbin ON CONTRACTS § 1020 at 124 and RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt.b (1981).

The Third Circuit faced the question of what to do about an obsolete state rule that has not yet been abrogated by the state itself. *In re Merritt Logan, Inc.*, 901 F.2d 349 (3d Cir. 1990), involved a claim for lost profits. New Jersey law applied and the defendants relied on the new business rule "embodied in several old New Jersey cases." *Id.* at 356. The court rejected the new business rule, holding (at 357):

> Moreover, we believe New Jersey would no longer follow a *per se* rule precluding all new businesses from recovering any damages for lost profits. The New Jersey cases that initially set forth the new business rule are more than fifty years old and the New Jersey Supreme Court has not had recent occasion to consider the rule. Accordingly, we must predict whether the New

Jersey [sic] would follow the rule against giving a new business damages for lost profits if it

* * *

(4)

Supreme Court, U.S.
FILED
JAN 10 2001
OFFICE OF THE CLERK

No. 00-825

In the
Supreme Court of the United States

OCTOBER TERM 2000

MINDGAMES, INC.

Petitioner,

v.

WESTERN PUBLISHING COMPANY, INC.

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITIONER'S REPLY BRIEF

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ARGUMENT

I. Overview

Stripped of pejoratives and rhetoric, Western's response is nothing more than a belated attempt to metamorphose arguments it made in the district court as reasons to apply the "new business" rule into an "alternative" basis for summary judgment independent of the rule. When the falsity of this attempt is exposed, Western's arguments against the petition collapse.

The majority rationalized affirming the summary judgment on the ground that MindGames failed to point out evidence from which lost royalties could be approximated in response to the argument in Western's "brief in this court" that "MindGames' claim for lost royalties was too speculative." App. 15. The extreme unfairness of this ruling is explained in Judge Fairchild's dissent (App. 17-18):

> It is true that in responding to Western's motion for partial summary judgment MindGames did not provide evidentiary material tending to show the breaches by Western nor that such breaches caused a loss of sales. This should not be deemed a waiver or forfeiture of an opportunity to do so because of *Western's complete reliance in its motion on the new business rule* and *Marvell*, which, if applied, would *prevent* proof of breach and causation of loss. Western's motion did not reach the issue of breach, and *establishing*

> *damages would require MindGames to prove that the breach occurred and caused loss of sales. . . . Western did not squarely assert, as an alternative ground, that MindGames could not prove to a reasonable certainty that any breach by Western caused loss of sales.* Rather, Western urged that the district court should strictly apply the new business rule.

(Emphasis supplied.)

Judge Fairchild put his finger on the problem this court should address: it is wrong to summarily deprive MindGames of its right to a jury trial for failing to produce evidence of lost sales and royalties in response to an argument first made by Western in the court of appeals when the *only* issue raised and considered in the district court was whether, as a matter of Arkansas law, MindGames had a right to introduce such evidence - when the only issue was not the availability of damage proof but whether the "new business" rule allowed it.

II. Western's "Alternative" Arguments Were Only Aspects of Its "New Business" Rule Argument.

Western's assertion that MindGames cannot seek lost royalties because it had no past profits is merely an aspect of the "new business" rule and was never presented as an "alternative" to the rule as a basis for summary judgment. The rationale for the "new business" rule is that the lack of a track record of past profits precludes a claim for future profits. Any distinction Western might try to imply is fruitless since under Arkansas law, which controls, the

absence of past profits does not prevent recovery of lost future profits.[1]

What Western actually argued below was that, "even if the Court were to reject a strict application of the New Business Rule, this [district] Court should still grant Western's motion for partial summary judgment because MindGames has no history of past profits" (App. 64), citing non-Arkansas cases that, in close analogy to the "new business" rule, preclude recovery of anticipated profits *as a matter of law* in the absence of past profits. Western did *not* argue that MindGames would be unable to demonstrate higher game sales absent breach.

Western's "uncertainty of the entertainment industry" argument was also part of its "new business" rule argument. It cannot justifiably tell this court the argument was in the alternative to its "new business" rule argument when it told the district court (App. 57):

> Even if the Court were to question whether the Arkansas Supreme Court would retreat from its across the board application of the New

---

[1] *Union National Bank of Little Rock v. Moshbacher*, 933 F.2d 1440 (8th Cir. 1991), *cert denied*, 502 U.S. 1031 (1992) (under Arkansas law established business can recover lost future profits despite recent loss history); *Jim Halsey Co. v. Bonar*, 683 S.W.2d 898 (Ark. 1985) (concert promoter can claim lost profits on future concerts despite absence of evidence of successful earlier promotions); *Finley v. North River Records, Inc.*, 148 F.3d 913 (8th Cir. 1998) (under Arkansas law a fledgling music concert promoter can recover lost future profits despite absence of any prior success).

> Business Rule, there can be no doubt that such a retreat would not be warranted here. It is particularly appropriate to apply this rule in the entertainment/consumer product industry where the chances of success are next to impossible to predict . . . .

The majority opinion itself recognized Western's argument as "just a variant of the discredited 'new business' rule." App. 13.

The requirement of proving damages to a reasonable certainty is not an "alternative" to Western's "new business" rule argument. This third and last supposed "alternative" is based upon Western's discussion of *Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410 (8th Cir. 1995). Far from citing *Hillside Enterprises* as the basis for an alternative ground for summary judgment, Western told the district court (App. 61): "The Eight[h] Circuit Court's opinion in *Hillside Enterprises* illustrates the rationale and application of the New Business Rule in the entertainment/consumer product industry."

Western's representation that it argued the reasonable certainty rule as an alternative basis for summary judgment is simply untrue. Western raised no argument or challenge that called upon MindGames to present proof of lost future sales of *Clever Endeavor* and attendant lost royalties in the district court.

Western could have positioned itself to make the alternative argument it now pretends to have made in the district court simply by propounding interrogatories seeking MindGames' evidence on lost sales and royalties, thus testing

the availability of required evidence as the defendant did in *Celotex Corp. v. Catrett*, 477 U.S. 317, 320 (1986). Western did nothing like that. Discovery on lost royalty damages was not reached, nor did Western support its motion with any evidence or record calling upon MindGames to develop and present evidence of lost sales and royalties. Accordingly, "speculative damages" as a separate ground for summary judgment was simply not raised below and cannot properly serve as a basis for affirmance.

III. No "Non-New Business" Rule Summary Judgment Issues Were Litigated in the District Court.

Without explanation Western asserts MindGames had to know it was being called upon to demonstrate lost sales and royalties because of Western's "non-new business rule argument" (Response at 12) that entertainment products are too speculative to be the subject of recoverable damages. As shown above, Western raised that issue only as part of its "new business" rule argument.

Western's characterization of the Blackwell summary judgment affidavits is misleading. The record shows Mr. Blackwell merely listed his damage theories, without attempting to provide an evidentiary basis for estimating lost sales. App. 93-96. Again, such evidence was not called for by Western's motion, predicated as it was on the sole ground that any such evidence should be precluded.

IV. Western's Responses to the Constitutional Arguments in the Petition Fail Because They Falsely Assume that MindGames Was Given Fair Notice of the Need and Opportunity to Present Evidence of Lost Sales and Royalties in the District Court.

The petition explains (at 12-20) how the court of appeals majority departed from the proper course of judicial proceedings and violated the Fifth and Seventh Amendments in granting a summary judgment *sua sponte* without MindGames having had fair notice and an opportunity to present evidence in the district court that *Clever Endeavor* sales and royalties were lost due to Western's multiple breaches of the License Agreement. Western does not deny these errors, if they occurred, would justify granting the petition. It argues only that it made the district court record required to support affirmance.

As shown above, Western put all its chips on the "new business" rule in the district court and did not make an alternative argument requiring MindGames to present evidence of lost sales and royalties.

Because the court of appeals affirmed even though Western failed both to make a proper record and to give proper notice, *Celotex* was violated. Western's argument (Response at 16) that a summary judgment can be granted, *sua sponte* or otherwise, without the nonmovant receiving fair notice of the evidentiary record it is required to make, is a perversion of *Celotex*, 477 U.S. at 317, too obvious to require response.

Western cites Wright & Miller, FEDERAL PRACTICE & PROCEDURE, § 2720 at 345 (1998) to the effect that the summary judgment movant need not produce evidence "but simply can argue that there is an absence of evidence by which the nonmovant can prove his case." Amen! Western has not pointed, and cannot point, to any record that it argued to the district court, "new business" rule or no, there is an absence of evidence by which MindGames can prove its case on lost game sales and royalties.

The ground relied on by the Seventh Circuit majority here is not "encompassed" in the arguments Western made in the district court. The gravamen of Western's summary judgment motion and of the district court's ruling was that MindGames had no right to offer proof of lost profits because the Arkansas "new business" rule precludes such proof as a matter of law. That is the polar opposite of arguing, "MindGames, you have the right to offer proof of lost royalties, if you have any. Show us your evidence." The former argument obviously does not encompass the latter.

The only "notice" mentioned by the majority here appears in the last paragraph of the opinion (App. 15):

> . . . Western in its brief *in this court* . . . did argue that in any event MindGames' claim for lost royalties was too speculative to ground an award of damages for that loss. The argument was brief but not so brief as to fail to put MindGames on notice of a possible alternative ground for upholding the district court's judgment; . . . .

(Emphasis supplied).

Western denies this is a reference to an argument presented only to the court of appeals – not to the district court. This court can easily judge that for itself.

Western goes so far as to argue that neither it nor the district court had any duty to notify MindGames of the need to present evidence on lost sales and royalties. Response at 22. If the majority ruling stands, Western would be right. But of course Western and the majority are wrong because *Celotex* places that very burden on a summary judgment movant and, in *sua sponte* summary judgments, on the district court. 477 U.S. at 323, 326. Western had the duty to show initially the absence of a genuine fact issue concerning MindGames' claim that game sales and royalties were lost or, at least, to challenge MindGames to demonstrate the presence of the issue. *Id.* It did not attempt to do so, filing no interrogatory answers or admissions and no deposition testimony going to the issue. It failed even to point out to the district court an absence of evidence to support MindGames' lost royalties claim. *See id.* at 325. MindGames' duty to present such evidence in the district court was thus never triggered. The Seventh Circuit cannot stay within constitutional bounds by affirming in the face of this record.

V. Western's Misconstrues the Seventh Circuit's "Reasonable Certainty" Analysis.

Western ends its brief with another attempted metamorphosis. After rehashing earlier arguments about lack of pre-breach profits and the vagaries of the entertainment industry, Western attempts to convert the majority ruling here

into a holding that MindGames could never pass the "reasonable certainty" test in any event. Response at 28-29.

Western elides over Arkansas's liberal rule that the requirement of "reasonable certainty" relates to establishing the *fact* of damages, not the *amount*.[2] *See* Judge Fairchild's dissent at App. 17.

More importantly, the Seventh Circuit did not abrogate the "new business" rule simply to resurrect it under the "reasonable certainty" rubric. It expressly disavowed any suggestion that "entertainment damages" are not recoverable. App. 13. Western ignores the "important qualification" that MindGames' damages remain speculative "given the evidence presented in the summary judgment proceedings." App. 14. The majority affirmed *not* because damages could not be proven but because "no evidence [was] presented from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter some broad but bounded range of alternative estimates, of copies of 'Clever Endeavor' would have been sold had Western honored the contract." App. 14 (emphasis by the court).

We explained above why the record lacks such evidence and why it is manifestly unfair to affirm on that basis.

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[2] *Union National Bank of Little Rock*, 933 F.2d at 1444 (Arkansas law); *Jim Halsey*, 683 S.W.2d at 903; *American Fidelity Fire Ins. Co. v. Kennedy Bros. Constr.*, 670 S.W.2d 798, 799 (Ark. 1984).

CONCLUSION

If the court of appeals can create grounds to affirm summary judgments outside of the district court record, summary judgment procedure becomes little more than a high stakes game of "gotcha." The rights and procedural issues at stake here are too important for this court to pass by. The petition should be granted.

Respectfully submitted,

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